

**Pensions Bill 2007**

**Pensions Bill -  
Impact Assessment**

5 December 2007



## Summary: Intervention & Options

<b>Department /Agency:</b> <b>Department for Work and Pensions</b>	<b>Title:</b> <b>Impact Assessment of the Pensions Bill</b>	
<b>Stage:</b> Introduction of Bill	<b>Version:</b> 1.0	<b>Date:</b> 5 December 2007
<b>Related Publications:</b> May 2006 White Paper and RIA; December 2006 White Paper and RIA; June 2007 Government consultation response; the Pensions Act 2007 and accompanying RIA		

Available to view or download at:

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

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

Millions of people in the UK are not saving enough for their retirement. Moderate to low earners are less likely to be saving in a private pension than other income groups. There are a number of barriers which prevent people from making a decision to start saving and these affect moderate to low earners in particular: many have a poor understanding of pensions and the need to save; inertia can prevent people from saving even when they are aware of the need to do so; the traditional route to retirement saving is occupational pension provision and this is in long term decline; and personal pension providers do not actively target this group because they struggle to recoup high upfront selling costs.

**What are the policy objectives and the intended effects?**

The policy aims to enable moderate to low earners to save more for retirement. The Government has outlined five tests for pension reform: to support personal responsibility, ensure fairness and simplicity, and deliver a package that is sustainable and affordable. The measures in this Bill meet each of these tests and build on the state pension reforms implemented in the Pensions Act 2007. The intended effects are to improve individuals' outcomes in retirement by making it easier and more attractive to save and to tackle inertia through automatic enrolment. The Government also wishes to support employers who voluntarily provide a good workplace pension scheme for their employees. We estimate that these reforms could have a positive social welfare impact equivalent to £40 billion between 2012 and 2050 and could lead to a 0.2 per cent increase in gross national product (GNP) in the long run.

**What policy options have been considered? Please justify any preferred option.**

The Pensions Act 2007 will greatly improve retirement outcomes, however many people may still not achieve the level of pension income they expect. No action could lead to future pressure to increase State Pensions, but the projected growth in the number of pensioners relative to those of working age would make this very costly to fund. The Government believes, and has achieved, a strong consensus that the reforms introduced in this Bill constitute the most effective form of Government intervention.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** There will be a review of key decisions relating to existing pension provision in 2017. The Personal Accounts Delivery Authority will be set objectives against which it will have to report annually.

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

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

Signed by the responsible Minister: Mike O'Brien .....Date: 05 December 2007

## Summary: Analysis & Evidence

<b>Policy Option:</b>	<b>Description:</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>	<p>Description and scale of <b>key monetised costs</b> by ‘main affected groups’ costs shown are average annual:</p> <p>Transfers: Employer contributions - £5.5 billion, Individual contributions - £7 billion, Government (tax relief, income-related benefits and Additional Pension) - £2 billion</p> <p>Resource costs: Employer administrative costs - &lt;£0.5 billion</p>
	<b>One-off</b> (Transition) <b>Yrs</b>	
	<b>£ 0.3billion</b> 1	
	<b>Average Annual Cost</b> (excluding one-off)	
	<b>£ 10-15billion</b>	<b>Total Cost (PV)</b> <b>£ 200-250billion</b>
<p>Other <b>key non-monetised costs</b> by ‘main affected groups’</p> <p>Compliance and related costs (commercially sensitive)</p>		

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>	<p>Description and scale of <b>key monetised benefits</b> by ‘main affected groups’ Transfers: Individuals - higher income in retirement (£15 billion per year of net pension income and tax revenue by 2050), Government: reduction in income-related benefit expenditure (£0.6 billion by 2050), Additional Pension (&lt;£0.5 billion), Employers – lower revaluation cap, £250 million per year on average.</p>
	<b>One-off</b> <b>Yrs</b>	
	<b>£ 0</b>	
	<b>Average Annual Benefit</b> (excluding one-off)	
	<b>£ 10-15billion</b>	<b>Total Benefit (PV)</b> <b>£ 200-250billion</b>
<p>Other <b>key non-monetised benefits</b> by ‘main affected groups’</p> <p>Benefits to individuals of consumption smoothing (equivalent to around £40 billion)</p> <p>Long run increase in UK incomes due to additional savings (0.2% of GNP in the long run)</p>		

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

Price Base Year 2007	Time Period Years 43	<b>Net Benefit Range (NPV)</b> <b>£ 0 to £5 billion resource cost,</b> <b>£40 billion social welfare</b>	<b>NET BENEFIT (NPV Best estimate)</b> <b>£ 3 billion resource cost, £40 billion social welfare benefit</b>
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What is the geographic coverage of the policy/option?	UK			
On what date will the policy be implemented?	2012			
Which organisation(s) will enforce the policy?	DWP, tPR			
What is the total annual cost of enforcement for these organisations?	£ commercially sensitive			
Does enforcement comply with Hampton principles?	Yes			
Will implementation go beyond minimum EU requirements?	Yes			
What is the value of the proposed offsetting measure per year?	£ 0			
What is the value of changes in greenhouse gas emissions?	£ negligible			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro £80	Small £80	Medium £200	Large £930
Are any of these organisations exempt?	No	No	N/A	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)			(Increase - Decrease)
Increase of    £ 89 million	Decrease of    £ 0	<b>Net Impact</b>	£ 89 million

Kev:

Annual costs and benefits: Constant Prices

## Evidence Base (for summary sheets)

### Explanation of cost and benefit estimates

1. The reforms outlined in this Impact Assessment give rise to transfers of income between different economic agents, such as employers, individuals and Government, and across people's lives. Overall, these transfers favour individuals through increased pension incomes in retirement.
2. Capturing the true costs and benefits of automatic enrolment and the minimum employer contribution is difficult as the costs arise in early years while the benefits mainly start when individuals retire. To take account of this, the costs and benefits assume a zero net present value of pension saving in the long-term: the present value of contributions made during a person's working life, including those from their employer and tax relief, is set to equal the gross increase in private pension income they experience. Where the rate of return on contributions is the same as the rate at which society discounts future income, pension saving represents a pure income transfer.
3. This increase in pension saving will be associated with millions of people enjoying increased well-being over their lifetime as a result of transferring income from a period when their income is relatively high (when they are working) to a period in which their income would otherwise be lower (after they retire). This results in a substantial welfare gain to society. We estimate that the present value of this effect is equivalent to at least £40 billion (further details are presented in Chapter 2). In addition, these reforms will also lead to a small increase in gross national product in the long-term.
4. The figures are consistent with the Better Regulation Executive guidelines<sup>1</sup> and are based on our central scenario of participation in workplace pensions following reform. Costs are in 2007/08 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.
5. The analysis covers the full benefits and costs arising from the operation of these reforms between 2007 and 2050. In the period prior to 2050 most of this will be seen as costs. However, the benefits from these reforms will continue to accrue for a long time after 2050 as people continue to enjoy a higher pension income in retirement than otherwise. These benefits continue to increase after 2050, as those who have lived a full working life under these reforms will start to retire in 2058.
6. If it becomes possible in the future to carry out this analysis over a longer timeframe, the present value of the costs and benefits presented would be greater. However, the overall conclusion, that this is a balanced package of reforms that will result in a significant increase in future pension incomes and to a substantial gain in social welfare, would remain the same.
7. The estimated resource costs reflect the cost of enabling people to transfer their income and achieve this gain in social welfare. These costs do not include the cost of setting up and operating the compliance regime as considerable further work needs to be done with the compliance body before a realistic estimate can be made. In addition, resource costs will arise in relation to the setting up and running of the personal accounts scheme, which in the long-term will be met through membership charges. These are not presented due

<sup>1</sup> <http://bre.berr.gov.uk/regulation/ria/>

to commercial sensitivities, although a charge has been factored into individuals' private pension incomes, for purposes of illustration.

## Specific Impact Tests: Checklist

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

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

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





## Executive summary

This Impact Assessment sets out the pension reform provisions contained in the Pensions Bill 2007. These aim to encourage and enable more people to save towards their retirement. They represent the second part of a package of radical reforms to the UK pensions system. These were initially set out in the May 2006 White Paper *Security in Retirement: towards a new pensions system*. The first part, a fairer and more generous state pensions system, was taken forward by the Pensions Act 2007.

In summary, the reforms contained in the Pensions Bill 2007 are:

- a duty on employers to automatically enrol jobholders into a qualifying workplace pension scheme and to offer a minimum pension contribution equal to 3 per cent of eligible earnings;
- introduction of personal accounts, a simple, low-cost pension saving scheme aimed at moderate to low earners who currently do not have access to a workplace pension scheme;
- to allow for a broadening of the Personal Accounts Delivery Authority's remit and powers to enable it to oversee the establishment of the personal accounts scheme;
- a proportionate compliance regime for the new employer duties, such as automatic enrolment, based upon a strategy of education, enablement and enforcement;
- strengthening existing workplace pension provision by reducing burdens imposed by rules governing private pensions; and
- further simplification of the state pensions system to give people a better understanding of the State Pension they are accruing and to support people in planning their retirement.

The proposals for automatic enrolment, a minimum employer contribution and a system of personal accounts are substantively the same as those set out in the May 2006 White Paper, the subsequent White Paper *Personal accounts: a new way to save* published in December 2006 and the Government's responses to those consultations<sup>2</sup>.

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<sup>2</sup> *Security in Retirement: towards a new pensions system – Summary of responses to the consultation*, Cm6960, published in October 2006; and *Personal accounts: a new way to save – Summary of the responses to the consultation Cm7121*, published in June 2007.

However, there are a number of areas where, following consultation and further policy development, the Bill provides greater detail on our initial proposals. These are:

- the definition of ‘earnings’ and ‘jobholder’ to which the automatic enrolment requirement will apply;
- the framework within which the personal accounts scheme will operate. This framework will be developed further in regulations and will draw on advice and recommendations from the Personal Accounts Delivery Authority;
- the framework for a proportionate, risk-based compliance regime that underpins the policy and minimises burdens on employers; and
- changes to existing private pension regulations arising from the Government’s response to the deregulatory review reviewers’ report, published in October 2007<sup>3</sup>.

The analysis within this Impact Assessment builds on that presented in the Regulatory Impact Assessments that accompanied the May and December 2006 White Papers<sup>4</sup> (hereafter referred to as the May and December Regulatory Impact Assessments). In particular, it contains new analysis to support recent policy decisions and on the likely impact of these reforms on the number of people saving for retirement in the UK, future private pension incomes and the administrative cost to employers.

As with any reform of the pensions system, many of the impacts described in this assessment represent income transfers within the economy rather than resource costs<sup>5</sup> or benefits to the economy as a whole. These income transfers occur between different employers, the Government and individuals or across different stages of people’s lives. These impacts should result in a large welfare gain for society by helping millions of people to save in a pension and smooth their consumption between their working lives and retirement. This is beneficial because, at current projected replacement rates, most people will place a higher value on the consumption they gain in retirement compared to that forgone during their working lives<sup>6</sup>.

Overall, our analysis shows that this is a balanced and affordable package of reform: making private saving easier and more accessible than ever before for moderate to

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<sup>3</sup> DWP, *Deregulatory Review – Government response*, published 22 October 2007

<sup>4</sup> *Security in retirement: towards a new pensions system – Regulatory impact assessments and technical appendices*, published in May 2006; and *Personal accounts: a new way to save* Regulatory Impact Assessment, published in December 2006.

<sup>5</sup> In economic analysis a distinction is drawn between ‘transfers’, such as social security payments and ‘resource costs’ which are payments for goods or services.

<sup>6</sup> Van de Coevering et al, *Estimating economic and social welfare impacts of pension reform* DWP pensions technical working paper, 2006.

low earners; minimising the burden on employers; and creating significant opportunities for the private pensions industry.

A detailed Gender Impact Assessment of the measures contained in this Bill will be published as a separate document<sup>7</sup>.

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<sup>7</sup> [www.dwp.gsi.gov.uk/pensionsreform](http://www.dwp.gsi.gov.uk/pensionsreform)



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# Chapter 1: Overview and summary of costs and benefits

## Objectives for reform

- 1.1 The proposals set out in the Pensions Bill 2007 aim to increase private pension saving in the UK. They form part of a wider reform package designed to ensure the UK has a pension system fit for the 21<sup>st</sup> Century which provides dignity and security for tomorrow's pensioners.
- 1.2 These proposals meet the five tests for pension reform that the Government set out in the May 2006 White Paper *Security in Retirement: towards a new pension system* (hereafter referred to as the May 2006 White Paper). These were to support personal responsibility and deliver fairness, simplicity, affordability and sustainability.
- 1.3 This document explains in more detail how the measures contained in this Bill will meet those five tests and how they will impact on individuals, employers, the Government and existing pension provision.

## Background

- 1.4 In December 2002, the Government established the Pensions Commission, chaired by Lord Turner, to consider the long-term challenges faced by the UK pensions system and whether the existing voluntary regime represented an adequate response.
- 1.5 In its Second Report<sup>8</sup>, published in November 2005, the Commission concluded that whilst there was no immediate 'pensions crisis', the existing system had to be reformed to ensure that it would meet several long-term challenges:
  - **demographic and social change:** increasing life expectancy and lower fertility rates mean that the proportion of our society of State Pensionable age is set to increase from around 11.3 million in 2006 to almost 15 million by 2031<sup>9</sup>. The Commission concluded that without an increase in saving, State Pensions or working lives, future pensioners would be, on average, worse off than those today;

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<sup>8</sup> *A New Pension Settlement for the Twenty-First Century: The Second Report of the Pensions Commission*, published November 2005.

<sup>9</sup> Source: National Statistics <http://www.statistics.gov.uk/pdfdir/pproj1007.pdf>.

- **undersaving for retirement:** the Commission estimated that between 9.6 and 12.1 million people<sup>10</sup> are not saving enough to deliver the pension income they are likely to want, or expect, in retirement. The Department for Work and Pensions (DWP) has since refined this estimate to be around 7 million<sup>11</sup>;
- **inequalities in the state pensions system:** the State system was rooted in the society of the 1940s and no longer reflected the way people live their lives today, especially as it failed to fully recognise the contributions of women and carers; and
- **complexity:** the Commission described the UK pensions system as the most complex in the world, hindering people's ability to make informed decisions about whether, when and how much to save.

1.6 In the May 2006 White Paper, building on this analysis and the Commission's recommendations, the Government set out its proposals for pension reform. In summary, these were:

- a simpler, fairer and more generous state pensions system, funded by a gradual increase in the State Pension age;
- a duty on employers to automatically enrol eligible jobholders into a workplace pension scheme;
- a national minimum employer pension contribution;
- a scheme of personal accounts to give moderate to low earners access to a simple and low-cost pension; and
- measures to strengthen existing provision by simplifying the rules governing occupational pension schemes.

1.7 The first part of this reform package, a fairer and more generous state pensions system, was implemented by the Pensions Act 2007. These measures will improve people's outcomes in retirement and provide a firmer foundation upon which people can plan for their retirement.

1.8 This second Pensions Bill builds on this firm foundation through a set of reforms, primarily to the private pension system, that will enable and encourage

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<sup>10</sup> *Pensions: Choices and Challenges: The First Report of the Pensions Commission*, published 2004.

<sup>11</sup> This figure is based on DWP modelling using data from the English Longitudinal Study of Ageing (ELSA) and was published in the May 2006 White Paper, *Security in retirement: towards a new pension system*. There are two main reasons for differences between the DWP and Pensions Commission figures: the DWP estimate is based on household level data, while the Pensions Commission's figures are based on individual level data (this means that an individual with a low pension themselves but whose spouse has enough for both would be counted by the Pensions Commission as an undersaver but not in the DWP's estimates); the Pensions Commission looked just at pension wealth, while the DWP estimates include other financial assets, non-owner occupied housing wealth and business assets.



more people to build up a private pension income to supplement that received from the state.

1.9 The proposals in this second Pensions Bill are largely as set out in the December 2006 White Paper *Personal accounts: a new way to save* (hereafter referred to as the December 2006 White Paper) and the Government's response to the subsequent consultation, which included:

- definitions of the age and earnings bands of jobholders who will be automatically enrolled, as well as the types of workplace pension schemes employers may use to fulfil their new obligations;
- a commitment to phasing both employer and jobholder contributions;
- a proportionate approach to compliance based on a strategy to educate, enable and enforce;
- a personal accounts scheme, set up as a trust-based occupational scheme, with a legal duty to act in its members interests and based on the National Pension Saving Scheme recommended by the Pensions Commission;
- the establishment of an executive Delivery Authority, distanced from Government, with the expertise to design and build the personal accounts scheme; and
- measures to minimise the impact of personal accounts on existing pension provision, including a prohibition on transfers into and out of the scheme and an annual limit of £3,600 on contributions.

1.10 In addition, following the May 2006 White Paper, the Government set up a deregulatory review of existing pension legislation, led by the independent reviewers, Chris Lewin and Ed Sweeney. They reported in July 2007<sup>12</sup> and the Government published its response in October 2007<sup>13</sup>, consulting on a number of proposals including a reduction in the cap applying to the revaluation of deferred pensions together with the introduction of a statutory override. A response to consultation is published alongside the Bill<sup>14</sup>.

## The case for reform

1.11 As outlined in paragraph 1.5, the Pensions Commission concluded that while the UK pensions system works well today, demographic change coupled with a continuing decline in private pension provision would lead many individuals to have inadequate incomes in retirement.

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<sup>12</sup> Lewin, C and Sweeney, E, 2007, *Deregulatory review of private pensions, an independent report to the Department for Work and Pensions*.

<sup>13</sup> *Deregulatory Review – Government response*, published 22 October 2007.

<sup>14</sup> *Deregulatory Review – Response to Consultation*, published 5 December 2007.

1.12 Although the changes to the state pensions system introduced through the Pensions Act 2007 make significant progress in addressing this challenge, many individuals will still need to make their own provision over and above that provided by the State if they are to enjoy the kind of retirement income they want and expect.

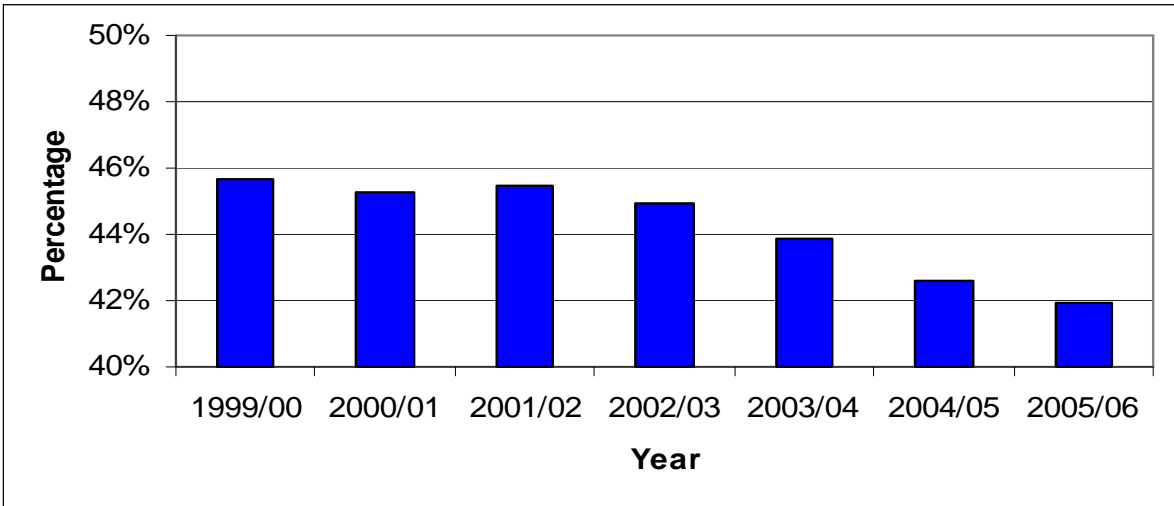
1.13 For example, as a result of the Pensions Act 2007 a median earner<sup>15</sup> retiring in 2055 can expect to achieve a replacement rate of 32 per cent from the State. However, this is still below the 45 per cent replacement rate the Pensions Commission used as a benchmark to broadly indicate an adequate level of income in retirement for a median earner. To reach this level, a median earner would need to save around 8 per cent of gross earnings for about 40 years.

1.14 However, millions of people in the UK are currently not saving for their retirement and many of those who are saving are not saving enough to generate the retirement income they might want and expect.

1.15 A significant number of the working-age population (42 per cent) are currently not contributing to a private pension. This figure is even higher among moderate to low earners, with 51 per cent of those earning between £5,000 and £25,000 not saving in a pension<sup>16</sup>.

1.16 Furthermore, the proportion of the working-age population saving towards their retirement is falling (Figure 1.1). This reflects a long-term decline in occupational pension provision that has not been offset by an expansion in individuals taking out personal pensions.

**Figure 1.1: Percentage of the working age population in Great Britain contributing to a private pension**



Source: Family Resources Survey  
Note: Working age is defined as between 20 and State Pension age. Data is for Great Britain.

<sup>15</sup> In 2007/08, median earnings were £23,400 according to the *Annual Survey of Hours and Earnings 2007*, published by the Office for National Statistics.

<sup>16</sup> Source: Family Resources Survey 2005/06.

1.17 The Pensions Commission suggested that, without Government intervention, private pension membership and contributions will at best remain level as longevity increases and may well continue to fall.

1.18 The May and December 2006 White Papers described why Government intervention is required to increase the number of people saving in a private pension. In particular, moderate to low earners face four principal barriers to saving for their retirement:

- many people have a poor understanding of pensions and of the benefits of saving for retirement. Only 5 per cent of people say they have a ‘good’ knowledge of pensions while two thirds claim their knowledge is ‘very patchy’ or they know ‘little or nothing’<sup>17</sup>. This lack of understanding results in a tendency to live for today rather than save for the future. Only 42 per cent of the working-age population are saving in a pension<sup>18</sup>, yet 74 per cent do not expect the state pensions system to provide them with an adequate level of income in retirement<sup>19</sup>;
- inertia often prevents people from starting to save even when they are aware of the need to do so. Research shows that many people have access to a workplace pension but fail to join, even when this appears to be in their interest and they are given information about the value of doing so<sup>20</sup>;
- traditionally the typical route to retirement saving has been through a pension scheme offered by a person’s employer. However, the provision of such schemes has been in long-term decline. Rapid increases in life expectancy, the end of the boom in the equity market in the late 1990s and the incremental growth of the regulatory system governing occupational pensions over the past 30 years have pushed costs higher than anticipated when the schemes were designed; and
- although significant elements of the pensions market work very well, it is failing many of those on moderate to low earnings or who work for small firms. This is illustrated in Figure 1.2 below which shows that employees working in large firms are more likely to be in a pension scheme and to be receiving relatively generous employer contributions compared to those working for small and medium-sized firms. It is more difficult for pension providers to recover the high upfront costs involved in selling pension products to this segment of the market and so they tend not to actively target it. This is compounded by the fact that ineffective demand within this segment of the market means there is little incentive or competitive pressure to reduce charges or improve services.

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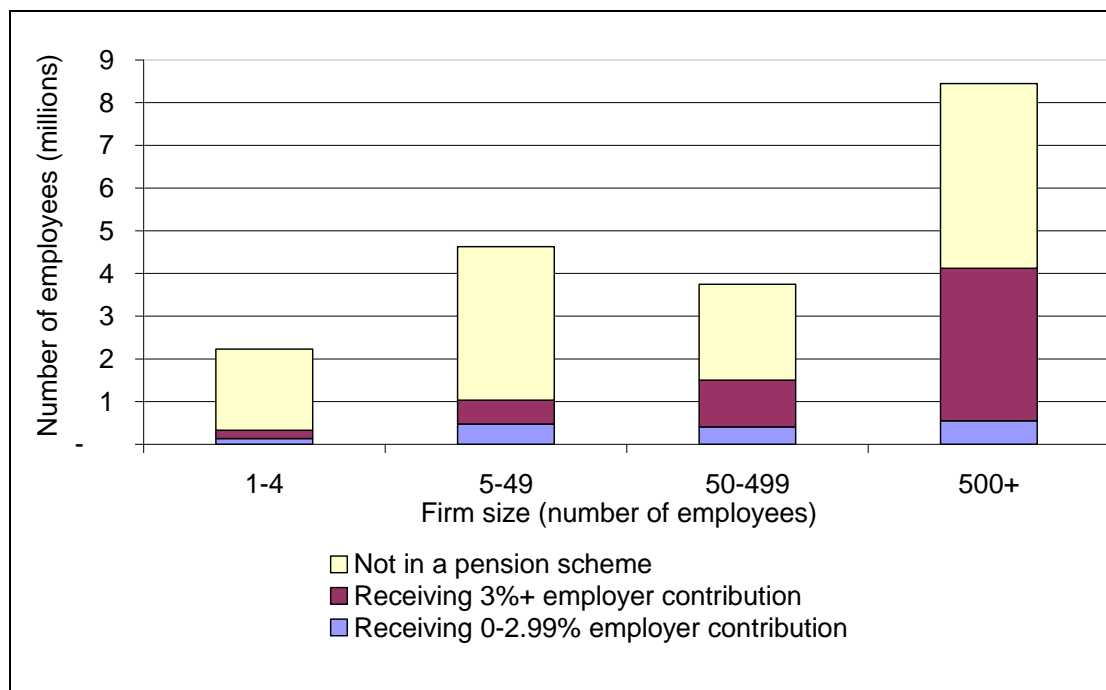
<sup>17</sup> Clery, E, McKay S, Phillips M and Robinson C, 2007, *Attitudes to pensions: the 2006 survey*, DWP Research Report 434.

<sup>18</sup> Family Resources Survey, UK, 2005/06.

<sup>19</sup> Marketing Sciences Ltd, 2006, *Retirement Planning Monitor*.

<sup>20</sup> Clery, E, McKay S, Phillips M and Robinson C, 2007, *Attitudes to pensions: the 2006 survey*, DWP Research Report 434.

**Figure 1.2: Existing pension provision – scheme membership by firm size**



Source: DWP analysis based on the Employers’ Pension Provision Survey 2005, Small and Medium-Sized Enterprise (SME) Statistics 2005 and the Annual Survey of Hours and Earnings 2005

1.19 The Government believes that action is therefore necessary to tackle these barriers and increase saving in the UK. No action would mean millions of people still not saving in a pension and, as a result, future generations of pensioners will face disappointment in retirement.

1.20 Alternatively, taking no further action now could possibly lead to pressure in the future to further increase the level of State Pensions. However, the projected growth in the number of pensioners compared to those of working-age would make the cost prohibitive. For example, if the Government increased the generosity of the basic State Pension so that a median earner received the benchmark replacement rate of 45 per cent suggested by the Pensions Commission, the estimated cost would be around £80 billion in 2007/08 prices by 2050<sup>21</sup>. This option constitutes compulsory saving for all and would, therefore, also increase the risk of oversaving for retirement for some groups.

1.21 The Government therefore agrees with the Pensions Commission’s conclusion that it is better to reform the existing system of voluntary private saving and to do so now.

## Building consensus

1.22 In order to plan and save for their futures, people need to be confident that the decisions they make today will not be undermined by frequent changes to the pensions system. The Government has therefore worked hard to build a broad-

<sup>21</sup> DWP modelling.

based consensus amongst political parties, the public, businesses and the pensions industry to ensure these reforms can stand the test of time.

1.23 Since the publication of the White Papers in May and December 2006, the DWP has carried out a comprehensive consultation to help build and maintain this consensus. As well as receiving written responses to its formal consultations, the Department has engaged extensively with stakeholders and the public to widen the debate and increase people's understanding of the issues. This has included:

- seminars;
- debates;
- online forums; and
- regular meetings with stakeholder organisations.

1.24 Extensive consultation was also carried out within the framework of the Deregulatory and Institutional reviews.

## Summary of Bill measures

1.25 The Government believes, and is supported by a strong consensus, that the private pension reforms being introduced through this Bill are the most effective way to encourage and enable more people to save more in private pensions. In particular, they tackle the barriers identified above by making it easier and more attractive to save, extending provision to those currently not covered by the market, strengthening existing provision and simplifying the decision to save.

1.26 In summary the measures being introduced in this Bill are:

- **Making it easier and more attractive to save (Chapter 2):**
  - automatic enrolment into a qualifying workplace pension;
  - a national minimum employer contribution of 3 per cent on earnings between £5,035 and £33,540<sup>22</sup> a year;
  - a minimum total overall level of contribution of 8 per cent on the same band of earnings;
  - a commitment to phasing employer and jobholder contributions; and
  - a straightforward qualifying test for existing schemes where guidance will be provided to support employers and advisors.

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<sup>22</sup> These earnings bands are expressed in 2006/07 earnings terms and will be updated by annual earnings growth. This will maintain the value of contributions in relation to earnings.

- **Extending access to low-cost saving: personal accounts (Chapter 3):**
  - establishing the personal accounts scheme as a trust-based occupational scheme;
  - a broadening of the Personal Accounts Delivery Authority’s remit and powers to enable it to oversee the establishment of the personal accounts scheme; and
  - an annual contribution limit of £3,600<sup>23</sup> and a ban on transfers in and out of the personal accounts scheme, in order to limit the impact of the reforms on the market.
- **Compliance (Chapter 4):**

The Pensions Regulator will have responsibility for the delivery of a proportionate and effective compliance regime which protects individuals whilst minimising the burdens on employers. The regime will include:

- a requirement for employers to register how they will meet their new duties<sup>24</sup>;
  - automated processes to follow up on employers who fail to register;
  - smaller-scale interventions, such as risk-based investigations;
  - new employee rights to protect against unfair dismissal or detriment on the grounds of pension membership and a whistle-blowing hotline; and
  - enforcement of payments in a way that reflects the importance to savers.
- **Strengthening existing pension provision (Chapter 5):**
    - a reduction in the cap applying to the revaluation of deferred pensions (to take effect from January 2009, applying only to rights accrued after that date);
    - repealing the rules on safeguarded rights; and
    - removing the stakeholder designation requirement from 2012, when automatic enrolment and personal accounts are introduced.

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<sup>23</sup> In 2005 earnings terms, uprated annually in line with earnings.

<sup>24</sup> Employers will be required to register once for each of their PAYE schemes and will have to inform the compliance body if they change the pension they use to meet their duties, or open a new PAYE scheme.

- **Improving trust in private pensions (Chapter 6):**
  - enabling compensation paid by the Pension Protection Fund to be shared when a person entitled to compensation divorces;
  - improving the operation of the Pension Protection Fund by clarifying when compensation may be paid to entitled recipients;
  - enabling the Pension Protection Fund to charge interest to schemes for late payments of the Pension Protection Levy; and
  - giving the Pensions Regulator the power to direct the actuarial assumptions used in the calculation of a pension scheme's liabilities.
  
- **Further simplifying the state pensions system (Chapter 7):**
  - enabling the consolidation of existing rights to the additional State Pension; and
  - introducing an assessed Income Period Run-On for Pension Credit claimants.

1.27 This Bill also includes measures to remove inconsistencies in existing legislation by introducing amendments to the Polish Resettlement Act (Chapter 8) and the Social Security Pensions Act (Chapter 9).

## Summary of costs and benefits

1.28 The reforms outlined in this Impact Assessment give rise to large transfers of income from individuals' working lives to their time in retirement. The majority of the impact of this Bill is therefore a transfer rather than a resource cost or benefit. However, this income transfer should lead to large welfare gains to society. These benefits arise because most people value consumption more highly in times, such as retirement, when they can afford it less.

1.29 The costs and benefits arising from the specific measures included in this Bill are detailed in the chapters that follow. The costs and benefits of this package taken together are summarised below.

### Impact on individuals

#### *Increased pension savings*

1.30 The introduction of automatic enrolment will lead to a large increase in the number of people saving in a pension. Evidence shows that automatic enrolment is one of the most effective ways of combating people's tendency not to act when faced with difficult financial decisions, by creating a presumption to save and

making it easier to do so<sup>25</sup>. Its impact also appears to be greatest amongst those groups whose scheme participation tends to be the lowest, for example, women and those on moderate to low incomes<sup>26</sup>.

- 1.31 There is broad public support for automatic enrolment. Nearly two-thirds (64 per cent) of those eligible for automatic enrolment are in favour of its introduction. While there can be differences between how people say they will act and what they actually do, 69 per cent say that, if they were automatically enrolled, they would be likely to continue to save and not opt out<sup>27</sup>.
- 1.32 In addition, the combination of a minimum employer contribution of 3 per cent and normal tax relief on pension savings will help to make saving more attractive and boost the savings of millions of moderate to low earners.
- 1.33 The introduction of personal accounts will also mean that those working for small employers or with moderate to low earnings will benefit from the same kind of low charges that up to now have only been enjoyed by those in large occupational pension schemes or able to make large contributions. As a trust-based occupational pension scheme, there will be a legal duty for trustees to act in members' best interests, whose views will be represented by a members' panel.
- 1.34 There is inevitable uncertainty at this stage about the number of people who will be brought into pension saving as a result of these reforms. The precise impact will depend on changes in the pensions landscape between now and 2012, as well as the choices made by millions of individuals and employers over how to exercise their new rights and responsibilities. The Government will continue to monitor these trends both in the run-up to and following the implementation of these reforms.
- 1.35 Taking account of the latest data and research, as well as recent policy decisions, our current working assumption is that the introduction of automatic enrolment and personal accounts will lead to between 6 and 9 million people saving more in a workplace pension each year. More than 1 million of these will already be saving in a workplace pension but will benefit from a higher employer contribution. In total we estimate that between 4 and 7 million people will participate in the personal accounts scheme and that an additional 1-2 million will be saving or saving more in other employer schemes<sup>28</sup>. Chapter 2 discusses these estimates in more detail and Annex F compares them with the estimates we presented in the December 2006 Regulatory Impact Assessment.

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<sup>25</sup> The *Employers' Pension Provision Survey 2005* findings show a link between automatic enrolment and increased levels of pension scheme membership. This is discussed in details in paragraph 2.50.

<sup>26</sup> Madrian and Shea, 2002, in Munnell and Sunden, 2004, *Coming up short: The challenge of 401(k) plans*, The Brookings Institute.

<sup>27</sup> Research by Ipsos MORI for DWP (Smith P, Webb C, Pye J, Robey R, and Jeans D, forthcoming in 2008, *Individuals' attitudes and likely reactions to the personal account reforms 2007; Report of a quantitative survey*). This is a nationally representative survey of those eligible for automatic enrolment, involving 754 face-to-face interviews with individuals in GB.

<sup>28</sup> Source: DWP modelling.



1.36 This increase in workplace pension participation will lead to a significant rise in people's retirement income in the future. We estimate that, by 2050, these reforms will lead to a total increase in private pension income of £11-16 billion (2007/08 prices) or £5-7 billion in 2007/08 earnings terms. This will mean private pension incomes rising, on average, by around 12 per cent for young pensioners (those aged from 68 to 75 in 2050), compared to without reform<sup>29</sup>.

### ***Consumption smoothing***

1.37 In addition to being financially better off in retirement, many individuals are also likely to enjoy increased well-being over their lifetime as they transfer income to a period in which they otherwise would be less well off<sup>30</sup>. As a result, society as a whole will feel better off. While this is not the same as actual increases in financial wealth, we estimate this welfare effect to be equivalent to at least £40 billion in total by 2050<sup>31</sup>.

### ***Deregulatory private pension measures***

1.38 Past changes to pension legislation have helped to improve member benefits and protection within occupational pension schemes. However, combined with rising longevity, this has meant that in some cases the cost of running such schemes has risen beyond what the sponsoring employer originally intended. Some employers have responded by closing their scheme or reducing members' benefits.

1.39 The measures arising from the deregulatory review aim to reduce the cost of running such schemes. The precise impact is difficult to estimate. However, if employers were to take advantage of all the potential savings available and use these to maintain or expand coverage of their existing schemes, it could increase provision by up to 165,000 - 265,000 members per year in the medium to long term, compared to our projection of membership of defined benefit schemes without this change.<sup>32</sup>

1.40 These savings will arise from lower benefits amongst some members. However, as the net effect will be to redistribute pension income from the best off scheme members to those who otherwise would have remained outside of the scheme, this would be expected to raise overall social welfare.

### ***A simplified state pensions system***

1.41 These measures to encourage and enable greater saving will be supported by further steps to simplify the State Second Pension. This will provide individuals

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<sup>29</sup> Based on DWP modelling using the Pensim2 model.

<sup>30</sup> The economic concept of diminishing marginal utility suggests that the additional increase in wellbeing from an extra unit of consumption falls as individuals consume more of a given item.

<sup>31</sup> Based on the methodology set out in the 2006 working paper, Van de Coevering et al, *Estimating economic and social welfare impacts of pension reform*, DWP pensions technical working paper. This analysis is explained in more detail in Chapter 2.

<sup>32</sup> Source: DWP modelling.

with greater clarity around their State Pension rights, enabling them to make more informed decisions about their private pension saving.

### Impact on employers

1.42 The Government's reform programme continues to place employers at the heart of pension provision and can only be successful with their support and involvement.

1.43 There is broad support from employers of all sizes for the proposals contained in this Bill. Employers recognise the long-term economic benefits of increased private pension saving and of the need to act now rather than wait until the problems become more acute. Emerging findings from a survey of employers' attitudes and likely reactions to the impact of automatic enrolment and personal accounts show that the majority of employers (58 per cent) think these reforms are a good idea<sup>33</sup>.

1.44 Many employers already support their employees in saving for retirement by providing a workplace pension and making contributions towards it. The Government supports this in many ways and measures to reduce the legislative burdens governing private pensions will strengthen this support. In the period to 2050, the present value of the savings to employers from a reduction in the revaluation cap could be as much as £4.4 billion<sup>34</sup>. As noted in paragraph 1.39, it is intended that employers will use these savings to continue to provide high quality schemes.

1.45 However, if society as a whole is to meet the challenges identified by the Pensions Commission, those employers not currently providing pensions also need to play a role. The introduction of automatic enrolment, including into personal accounts, will lead to both administrative and contribution costs to employers. The majority of these will fall on employers who currently do not provide pensions to their employees.

1.46 Since the December White Paper, a cross-government group has been working to develop a better understanding of what these reforms will mean for employers and to refine our estimate of the administrative cost to employers. The findings from this work are set out in Chapter 2 and Annex G and will be used to inform the detailed design and implementation of automatic enrolment and the personal accounts scheme to ensure employer burdens are minimised.

1.47 Total administrative costs to those employers automatically enrolling their workers into personal accounts are estimated to be £300 million for the first year, with ongoing costs of around £89 million per year. Firms using an existing scheme will face total administrative costs of £50 million in the first year and

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<sup>33</sup> Research by BMRB International for DWP (Grant C, Fitzpatrick A, Sinclair P and Donovan JL, forthcoming in 2008, *Employers' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*). This is a nationally representative survey of approaching 2400 private sector employers across a range of size bands.

<sup>34</sup> Source: DWP modelling.

ongoing costs of £12 million per year<sup>35</sup>. The majority of firms expected to automatically enrol their workers into an existing scheme already run an occupational scheme. They will therefore face lower costs than those who are new to pension provision, many of whom will use personal accounts.

1.48 The total cost of contributions made by employers is estimated to be approximately £2.9 billion per year once contributions have been fully phased in, equivalent to 0.7 per cent of total labour costs<sup>36</sup>. Most employers expect to use a range of mechanisms for managing these costs, including absorbing increases as part of their overhead costs<sup>37</sup> (28 per cent), passing them onto consumers via higher prices (21 per cent) or in the form of slower wage growth (14 per cent)<sup>38</sup>. Depending on how the employer chooses to manage these increased labour costs, the net impact of some of these headline costs could be reduced by either a fall in the corporation tax paid or by lower employer National Insurance contributions, compared to what would otherwise have been payable.

1.49 The Government has sought to minimise burdens on employers, including small firms which make up the majority of businesses in the UK<sup>39</sup>. Key measures aimed at achieving this include:

- a commitment to phasing in both employer and jobholder contributions;
- designing a straightforward qualifying test for existing schemes;
- allowing 'high quality schemes' to operate deferral periods;
- a proportionate but effective compliance regime;
- choosing a delivery model for the personal accounts scheme that minimises burdens on employers<sup>40</sup>; and
- for the longer term, establishing an employer panel to represent employers' views within the scheme.

## Impact on Government

1.50 There will be costs to Government in relation to implementing these reforms, arising, for example, from providing information to employers on their new duties and setting up the compliance regime to regulate the duty on employers to automatically enrol jobholders into a workplace pension scheme.

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<sup>35</sup> Source: DWP modelling.

<sup>36</sup> Source: DWP modelling.

<sup>37</sup> This may include profits.

<sup>38</sup> Research by BMRB International for DWP (Grant C, Fitzpatrick A, Sinclair P and Donovan JL, forthcoming in 2008, *Employers' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*).

<sup>39</sup> Source: Small and Medium-Sized Enterprise (SME) Statistics 2006.

<sup>40</sup> Minimising burdens employers was a key factor used by the Department for Work and Pensions to evaluate and decide on the most suitable model for delivering personal accounts.

- 1.51 The increase in private pension savings generated by these reforms will increase the tax relief paid on pension contributions. The annual cost to the Exchequer could be around £1 billion once contributions have been fully phased in<sup>41</sup>. The employer contribution could also have an impact on the Exchequer. If employers choose to fund their contributions out of company profits, there would be a reduction in corporation tax paid. If it were funded through reduced wage growth, the Exchequer would forego employee income tax and National Insurance contributions from both employer and employee. The impact on the Exchequer could be a further £0.7 to £1.5 billion in 2014<sup>42</sup>.
- 1.52 The costs to Government of these reforms will be partially offset by higher private pension saving increasing future tax receipts and reducing the number of pensioners on income related benefits.
- 1.53 There will also be a need to finance the cost of set-up and early years operation of the personal accounts scheme, in the period before revenue from membership charges builds up. This finance could potentially come from private sector sources, public sources or a mixture of both. However, the Government has made clear that its intention is that the scheme will be self-financing over the long-term. Any Government support will not unfairly subsidise the scheme and will comply with European Union competition and procurement rules.
- 1.54 Further detail on the impact on Government can be found in paragraphs 2.123-2.129 and 3.79-3.85.

### Impact on industry

- 1.55 Overall, these reforms will have a positive impact on the financial services industry. New commercial opportunities will arise from a significant expansion in the sector as a whole, with around 6-9 million<sup>43</sup> more people saving in a workplace pension for the first time or benefiting from an increased employer contribution.
- 1.56 Simple, straightforward scheme qualifying tests will enable employers to fulfil their new legal obligations by continuing to provide high quality pensions or choosing from the products offered by existing providers. Overall, we estimate that the number of people saving or saving more in existing pension provision will increase by around 1-2 million<sup>44</sup>.
- 1.57 Private sector firms will also be able to provide the services needed to deliver the personal accounts scheme and procurement of these services will be carried out in a way that ensures effective competition.

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<sup>41</sup> DWP modelling based on data from the Employers Pension Provision Survey 2005 and the Annual Survey of Hours and Earnings (ASHE) 2005. Figures are expressed in 2007/08 prices.

<sup>42</sup> Using the methodology set out in Appendix E of the May 2006 Regulatory Impact Assessment.

<sup>43</sup> DWP modelling.

<sup>44</sup> DWP modelling.

- 1.58 Some commentators within the industry have expressed fears that some employers could choose to reduce contributions into existing schemes in response to increased costs. These concerns should be considered against a backdrop of a long-term decline in occupational pension provision where there is no floor for employer pension contributions and the fact that most of the costs to employers will fall on those not currently making any pension provision at all for their workers.
- 1.59 The Government is not complacent about this risk and is introducing a number of measures, such as a deferral period for higher contribution schemes, to mitigate it. It will also continue to monitor trends within the industry and gather evidence on the likely response of employers to these reforms.
- 1.60 New survey evidence shows that about half of employers who are already making contributions of 3 per cent or more plan to offer these contributions to new employees. Around 3 in 10 firms say they might consider not extending this level of provision to all employees. However, it tended to be smaller employers who said this. An analysis of employers with five or more employees shows that 64 per cent of employers contributing 3 per cent or more plan to offer their existing contribution levels or even higher to new employees, and only 17 per cent say they might consider not extending this level of provision to all employees<sup>45</sup>.

### Competition impacts

- 1.61 The personal accounts scheme will be a major new product in the pensions market and as such will change the way the existing market works. In particular, it will provide a simple, low-cost retirement savings vehicle for individuals and employers who are currently not well served by the existing market because the industry currently finds them to be unprofitable.
- 1.62 Specific measures, such as a prohibition on transfers and a limit on contributions, will be implemented to ensure that the personal accounts scheme remains targeted on those not currently served by the pensions market. However, whilst the scheme is being designed to complement, not replace, existing products, some employers will be able to exercise a choice between using personal accounts and other pension schemes to fulfil their legal duty. Where this is the case, personal accounts will be adding choice into a segment of the pensions market, which could create pressure to reduce charges and improve service standards.
- 1.63 Personal accounts will be delivered using capabilities procured from the private sector and will give rise to large contracts which could boost competition in a range of markets. Procurement processes are being put in place to ensure effective competition for the provision of these capabilities. Best practice will be adhered to throughout. All contracts will be let in accordance with the Public

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<sup>45</sup> Research by BMRB International for DWP (Authors, forthcoming in 2008, *Employers' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*).

Contracts Regulations (2006). Annex B contains a complete assessment of the competition impacts of our reforms.

### Impact on the macro economy and the labour market

- 1.64 These reforms are likely to have a relatively small effect on economic growth<sup>46</sup>. While increased saving may cause a temporary and very small fall in economic activity, it will quickly return to the level it would otherwise have been. In the long run, the additional saving generated could result in national income being around 0.2 per cent higher – as measured by Gross National Product<sup>47</sup>.
- 1.65 This analysis is based on an estimate of additional savings equivalent to just less than 0.5 per cent of Gross Domestic Product<sup>48</sup>. The impact on financial markets of such a savings increase is likely to be limited. To provide some context, the current stock of pension savings is estimated to be around £1,400 billion<sup>49</sup>.
- 1.66 The December 2006 Regulatory Impact Assessment set out the impacts of these reforms on the labour market. The extent to which the increase in employer costs feeds through to employment depends on the mechanisms employers use to manage these costs. The latest evidence on employers' likely responses was set out in paragraph 1.48. The empirical literature on the impact of increases in non-wage labour costs suggests the long-run employment impact if a tax of this scale were to be introduced would be around one-sixth of 1 per cent of private sector employment<sup>50</sup>. However, personal accounts is not a tax. As there is no direct precedent for personal accounts, it is difficult to quantify the precise size of any employment impact but the effects are expected to be very small.

### Gender impacts

- 1.67 Historically, there has been inequality in pension outcomes between men and women. The improvements to the state pensions system contained in the Pensions Act 2007 will help tackle this<sup>51</sup> by recognising the social as well as economic contribution made by women and carers.
- 1.68 The reforms set out in this Bill will build on this by delivering improved private pension incomes for men and women. For the first time there will be genuine equality of opportunity in the access to private pension provision, which will enable more women to take responsibility for their own income in retirement. A

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<sup>46</sup> Coevering, van de, et al. (2006) *Estimating economic and social welfare impacts of pension reform*, DWP Pensions technical working paper.

<sup>47</sup> Gross National Product (GNP) is the value of all goods and services produced in a country in one year, plus income earned by its residents abroad, minus income payable to non-residents.

<sup>48</sup> Gross Domestic Product (GDP) is a measure of economic activity in a country. It is calculated by adding the total value of a country's annual output of goods and services.

<sup>49</sup> UBS Global Asset Management, *Pension Fund Indicators 2006*.

<sup>50</sup> OECD research (for example OECD, 1994, *OECD Jobs Study*), suggests a larger impact on the lower paid of an increase in non-wage labour costs.

<sup>51</sup> DWP, *The Gender Impact of Pension Reform*, published November 2006.

Gender Impact Assessment will be published separately alongside this document and is summarised in Annex C.

### **Race impacts**

1.69 The Government's package of pensions reforms is expected to have a disproportionately positive impact on black and minority ethnic (BME) groups compared to people from white ethnic backgrounds. This is because automatic enrolment is targeted predominantly at moderate to low earners who are currently not participating in a pension with a 3 per cent or more employer contribution. BME individuals form 12 per cent of this group<sup>52</sup>, whereas they represent 9 per cent of all employees aged 22 to State Pension age. Automatic enrolment will mean that many individuals in BME groups who would otherwise not have saved will start to do so. Annex D assesses the race impacts more fully.

### **Disability impacts**

1.70 The Government's package of pensions reforms is expected to have a similar impact on disabled people in employment as on those who are not disabled. Annex E assesses the impacts on disabled people more fully.

### **Summary of costs and benefits – the figures**

1.71 The reforms outlined in this Impact Assessment give rise to transfers of income between different economic agents, such as employers, individuals and Government, and across people's lives. Overall, these transfers favour individuals through increased pension incomes in retirement.

1.72 Capturing the true costs and benefits of automatic enrolment and the minimum employer contribution is difficult as the costs arise in early years while the benefits mainly start when individuals retire. To take account of this, the costs and benefits shown in Table 1.1 assume a zero net present value of pension saving in the long-term: the present value of contributions made during a person's working life, including those from their employer and tax relief, is set to equal the increase in gross private pension income they experience. Where the rate of return on contributions is assumed to be the same as the rate at which society discounts future income, pension saving represents a pure income transfer.

1.73 This increase in pension saving will be associated with millions of people enjoying increased well-being over their lifetime as a result of transferring income from a period when their income is relatively high (when they are working) to a period in which their income would otherwise be lower (after they retire). This results in a substantial welfare gain to society. We estimate that the present value of this effect is equivalent to at least £40 billion (further details are presented in Chapter 2). In addition, as set out in paragraph 1.64, these reforms will also lead to a small increase in Gross National Product in the long-term.

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<sup>52</sup> Private pension participation has been used as a proxy for participation in a pension with a 3 per cent or more employer contribution. Higher earners are defined as those earning £33,000 or more per year.

- 1.74 The figures set out in the tables below are consistent with the Better Regulation Executive guidelines<sup>53</sup> and are based on our central participation scenario. Costs are in 2007/08 prices, which means 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<sup>54</sup>.
- 1.75 The analysis covers the full benefits and costs arising from the operation of these reforms between 2007 and 2050. In the period prior to 2050 most of this will be seen as costs. However, the benefits from these reforms will continue to accrue for a long time after 2050 as people continue to enjoy a higher pension income in retirement than otherwise. These benefits will continue to increase after 2050, as those who have lived a full working life under these reforms will start to retire in 2058.
- 1.76 The estimated resource costs, shown in Table 1.3, reflect the cost of enabling people to transfer their income and achieve this gain in social welfare. These costs do not include the cost of setting up and operating the compliance regime as considerable further work needs to be done with the compliance body before a realistic estimate can be made. The Government broadly expects this to be in the region of up to £1 billion in net present value terms over the period to 2050. In addition, resource costs will arise in relation to the setting up and running of the personal accounts scheme, which in the long-term will be met through membership charges. These are not presented due to commercial sensitivities, although a charge equivalent to a 0.5 per cent reduction in yield has been factored into individuals' private pension incomes, for purposes of illustration.

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<sup>53</sup> <http://bre.berr.gov.uk/regulation/ria/>

<sup>54</sup> [http://www.hm-treasury.gov.uk/economic\\_data\\_and\\_tools/greenbook/data\\_greenbook\\_index.cfm](http://www.hm-treasury.gov.uk/economic_data_and_tools/greenbook/data_greenbook_index.cfm)



<b>Table 1.1: Summary of transfer and resource costs</b>			
	Total cost (present value)	Total benefit (present value)	Net benefit (present value)
Value of transfers (£ billion)	200 – 250	200 – 250	0
Resource costs (£ billion)	3.5	0.5	-3
Social welfare benefits (units of consumption, in billions)	0	40	40

## 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 2007-2050, and are presented in 2007/08 prices.
- Costs are rounded to the nearest £100 million.
- Costs are presented as negative numbers, benefits as positive numbers.
- As explained in paragraph 1.76, there will be additional costs of setting up and operating the compliance regime and the personal accounts scheme, which are not presented here.

<b>Table 1.2: Transfer costs and benefits arising from measures contained in the Pensions Bill (£ million)</b>						
	One-off cost (present value)	2012	2020	2030	2040	2050
<b>Individuals</b>						
Contribution costs	0	-800	-5,300	-6,500	-7,900	-9,600
Higher private pension income (gross of tax and net of charges)	0	0	400	3,000	9,100	14,900
Reduction in receipt of income related benefits	0	0	*	-100	-200	-600
Lower revaluation cap	0	*	-100	-300	-400	-400
<b>Net benefit</b>	<b>0</b>	<b>-800</b>	<b>-5,000</b>	<b>-3,900</b>	<b>600</b>	<b>4,300</b>
<b>Employers</b>						
Contribution costs <sup>1</sup>	0	-1,100	-4,400	-5,400	-6,600	-8,000
Lower revaluation cap	0	*	100	300	400	400
<b>Net benefit</b>	<b>0</b>	<b>-1,100</b>	<b>-4,300</b>	<b>-5,100</b>	<b>-6,200</b>	<b>-7,600</b>
<b>Government</b>						
Contribution costs (tax relief)	0	-200	-1,300	-1,600	-2,000	-2,400
Reduced income related benefit expenditure	0	0	0	100	200	600
Second State Pension consolidation <sup>2</sup>	0	0	-100	-300	200	400
<b>Net benefit</b>	<b>0</b>	<b>-200</b>	<b>-1,400</b>	<b>-1,800</b>	<b>-1,600</b>	<b>-1,400</b>

## Notes:

- Costs cover the UK.
  - All figures are expressed in 2007/08 prices and are rounded to the nearest £100 million.
  - Costs are presented as negative numbers, benefits as positive numbers.
1. The costs presented here are the sum of employer contributions and tax relief on those contributions. The distribution of these costs will depend on how employers manage costs.
2. This constitutes a time-shift of expenditure and does not have an impact on individuals' pensions.
- \* means that small costs or benefits arise but these are rounded to 0.

<b>Table 1.3: Resource costs and benefits arising from measures contained in the Pensions Bill (£ million)</b>						
	One off cost/benefit (present value)	2012	2020	2030	2040	2050
Employer administrative costs	-200	-100	-100	-200	-200	-200
Cost of changing scheme rules	-100	0	0	0	0	0
Removal of Stakeholder designation requirement	-	*	*	*	*	*
<b>Net Benefit</b>	<b>-300</b>	<b>-100</b>	<b>-100</b>	<b>-200</b>	<b>-200</b>	<b>-200</b>

## Notes:

- Costs cover the UK.
  - All figures are expressed in 2007/08 prices and are rounded to the nearest £100 million.
  - Present values are for the period 2007-2050, and are presented in 2007/08 prices.
  - Costs are presented as negative numbers, benefits as positive numbers.
  - As explained in paragraph 1.76, there will be additional resource costs of setting up and operating the compliance regime and the personal accounts scheme, which are not presented here.
- \* means that small costs/benefits arise but round to 0.



# Chapter 2: Making it easier and more attractive to save

## Automatic enrolment and mandatory employer contributions

### Objectives

- 2.1 The introduction of automatic enrolment and a minimum employer contribution will make it easier and more attractive for individuals to save in a pension. The objectives of the reforms are to:
- increase private pension saving by overcoming the inertia that stops many workers from starting to save, even when they recognise the need to do so;
  - increase the attractiveness and amount of saving through a minimum 3 per cent employer contribution and normal tax relief on pension savings; and
  - enable employers to maintain the existing good pension provision that many of them already voluntarily provide.
- 2.2 In making these changes the Government aims to minimise the burden on employers by designing a suitable policy framework and phasing in the minimum employer contributions in order to help them adjust to the costs of extending pension provision.
- 2.3 The Government will also set up a simple and low-cost retirement savings vehicle for those without access to pension saving. This is explained in more detail in Chapter 3.

### Rationale

- 2.4 As set out in the Chapter 1, without Government intervention to increase the number of people saving in a private pension, the problem of inadequacy of retirement savings identified by the Pensions Commission will continue to grow.
- 2.5 This chapter sets out how we intend to introduce an employer duty to automatically enrol jobholders into qualifying workplace pension arrangements. This is needed to tackle the inertia that can exist in private pension saving, whereby many individuals do not make the decision to start saving even when

they are aware of the need to do so<sup>55</sup>. We will encourage workers to continue saving in a pension through mandatory minimum employer contributions, which will provide a clear incentive to save and help those on moderate to low incomes to build up their pension entitlement.

- 2.6 Employers are crucial to achieving the desired outcome of the reforms. That is why Government is working to balance the overarching objective of increasing pension saving among workers on moderate to low incomes with the need to minimise the burdens on businesses and support the continuation of good existing pension provision.

## Summary of proposals

- 2.7 The measures set out below are largely as outlined in the May and December 2006 White Papers and subsequent consultation responses.
- 2.8 The Government recognises that employers will be affected both by the policy framework set out in the Bill and by the business operations designed to deliver the reforms. We believe the policy framework is based soundly on the available evidence and strikes a balance between minimising burdens on employers and enabling individuals to build up meaningful savings. Government and the Personal Accounts Delivery Authority will continue to ensure the design is such that burdens on employers are minimised. At this stage, rightly, the business processes for employers have not yet been decided. While the Bill will confirm key elements of the reforms for employers, it will also provide for future flexibility in some areas to enable Government to continue to consult with employers and their representatives. This will allow the detailed design to respond to new evidence and changing market contexts to ensure that the overall reforms remain coherent whilst minimising the impact on employers.

### **The employer duty to automatically enrol**

- 2.9 In order to overcome inertia, we will place a responsibility on employers to automatically enrol jobholders into qualifying workplace pension arrangements, of which the personal accounts scheme will be one option. The decision whether to save or not will remain with individuals, who will be free to opt out should they wish.

### **Who will be automatically enrolled?**

#### ***Definition of worker***

- 2.10 The Government has decided that employers will be required to automatically enrol all employees or workers into a qualifying workplace pension arrangement. This definition will align the eligibility for automatic enrolment into private pension

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<sup>55</sup> Clery, E, McKay S, Phillips M and Robinson C, 2007, *Attitudes to pensions: the 2006 survey*, DWP Research Report 434.

saving with coverage of the Working Time Directive and the National Minimum Wage Act.

- 2.11 We believe this provides the best fit with the aim of increasing private pension saving. An alternative approach would have been to restrict the legislative definition to ‘employees’. This would potentially exclude around 1.5 million<sup>56</sup> people in the workforce who are classified as workers. This would include agency workers, a number of whom are likely to be on moderate to low earnings.

### ***Age bands***

- 2.12 As we have previously announced, employers will be required to automatically enrol workers aged between 22 and State Pension age, provided their earnings are above the lower threshold of the earnings band, discussed in paragraph 2.13. Those outside of this age range will not be automatically enrolled. However, workers between the ages of 16 and 22, and between State Pension age and 75, may apply to join their employer’s pension scheme and receive an employer contribution on eligible earnings.

### ***Earnings threshold***

- 2.13 The lower earnings threshold above which workers will be eligible for automatic enrolment will be £5,035 (in 2006/07 earnings terms) uprated annually taking into account average earnings growth. This will avoid automatic enrolment of people on very low incomes who are likely to have relatively high rates of income replacement from their State Pension income, particularly if they have consistently experienced lower earnings throughout their working lives. Those earning below this level may apply to join their employer’s pension scheme if they wish, although employers will not be obliged to provide an employer contribution as the earnings will not fall within the eligible earnings band.

### ***Re-enrolment***

- 2.14 As previously announced, we intend to give those workers who opt out of saving the opportunity to review that decision by requiring employers to re-enrol them into a qualifying scheme at regular intervals.
- 2.15 We will start by setting a minimum period of three years during which employers will not be required to re-enrol jobholders. The Personal Accounts Delivery Authority will be providing further advice before a final decision on the actual period is reached.
- 2.16 It will be important to set an interval that strikes an appropriate balance between the key needs of maximising participation and minimising the administrative burdens on both employers and schemes. The initial interval also needs to fit with the rollout of the overall package of pension reforms. Consideration will be given to the impact of job churn and other participation

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<sup>56</sup> DTI, *Increasing the Holiday Entitlement: Partial Regulatory Impact Assessment*, 2007.

factors on scheme costs, in the form of processing peaks, and administrative costs to employers.

### ***Enrolment in other cases***

2.17 The Government believes it is important to allow people who opt out of automatic enrolment or who cancel their membership of a scheme, to change their mind and re-apply to join. People's circumstances change all the time. It is not reasonable to prevent people who want to start pension saving from doing so until re-enrolment. The Government has therefore included a provision to ensure these workers are able to opt in at least once in every 12 month period.

### ***Voluntary members of personal accounts***

2.18 The Government also believes it is important to provide an accessible pensions savings product for self-employed people and for members of the personal accounts scheme who wish to continue to save during periods out of paid work, for example if they take a career break due to caring responsibilities. The Government will introduce regulations to provide these groups with access to the personal accounts scheme.

## **What will employers be required to pay?**

### ***The minimum contribution level***

2.19 The Government has determined that there will be an overall minimum contribution of 8 per cent of eligible earnings into defined contribution schemes. At least 3 per cent of this must be funded by the employer. The default 5 per cent worker contribution includes a contribution from government in the form of tax relief on pension savings.

2.20 While the overall minimum contribution rate will be established at 8 per cent, the Government believes some employers and workers will contribute more, as they already do in many cases. A higher employer contribution may be used to take the total contribution rate above the minimum 8 per cent or offset some, or all, of the cost to the worker of contributing at the default rate.

## **What will the employer contribution be payable on?**

### ***Earnings band***

2.21 As we have previously announced we will establish a pension contributions earnings band with a lower and upper limit of £5,035 and £33,540 respectively (in 2006/07 earnings terms)<sup>57</sup>, and uprate these limits annually taking into account rises in average earnings. The earnings band will focus the reform on moderate to low earners and cap employer contributions.

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<sup>57</sup> DWP, *Personal accounts: a new way to save, Regulatory Impact Assessment*, published December 2006, paragraphs 3.2 to 3.20.



### ***Pay components***

2.22 The Government has now decided that the components of pay on which both worker and employer contributions will be calculated are: basic earnings, monetary payments of commission or bonus, overtime and Statutory Benefits.

2.23 In setting out the components of pay on which both worker and employer contributions will be calculated, the Government has sought to strike a balance between:

- a sufficiently wide definition to maximise savings, particularly among the low paid, and minimise the potential for avoidance;
- minimising the impact on qualifying schemes; and
- minimising any administrative impact on employers using the personal accounts scheme.

2.24 We recognise that existing schemes take a range of approaches to pay components for the purposes of calculating pension contributions. For example, some do not calculate contributions on overtime or bonus payments. We will not require all qualifying schemes to use this exact definition but we will require them either to meet this minimum standard or provide an equivalent minimum contribution.

### ***Pay periods***

2.25 To minimise the burden on employers, Government has now decided that the calculation of pension contributions should be aligned with the pay period over which the worker has their pay calculated. For example, the contributions due for a monthly paid worker will be 8 per cent of any earnings within the earnings band they receive over one-twelfth of the lower threshold of the earnings band.

### **How will existing schemes meet the new requirement?**

2.26 Employers can choose to automatically enrol their workers into a qualifying scheme providing the scheme meets specified qualifying criteria.

2.27 The Government has considered, consulted on and designed qualifying tests for occupational defined contribution and defined benefit schemes based on a simple set of key criteria. Regulations will specify when an actuary will be required to confirm that the scheme meets the test.

2.28 These tests will help employers to choose the form of pension provision that suits them and their workers, while ensuring this meets simple minimum standards. They will also ensure that the personal accounts scheme complements, rather than replaces, existing workplace pension provision. Guidance will be provided for employers in applying the qualifying tests.

### ***Defined contribution occupational schemes***

2.29 A defined contribution scheme is one where the scheme member receives a pension based on the contributions made and the investment return that their pension fund produces. These are also referred to as ‘money purchase’ schemes.

2.30 The minimum contribution levels, definitions of earnings bands and eligible pay outlined above will set the minimum benchmark for contributions in the qualifying test for defined contribution occupational schemes. Where employers calculate contributions using different rates, earning bands or definitions of pensionable pay, they will still be able to register their scheme as one which qualifies, providing scheme rules ensure that contributions do not fall below the cash equivalent of the minimum level.

### ***Workplace personal pension arrangements***

2.31 A workplace personal pension arrangement is any personal pension, or collection of personal pensions, to which the employer makes a contribution. This includes group personal pensions and group stakeholder pensions. An eligible worker who is already in a workplace personal pension arrangement which broadly meets the quality requirements set for defined contribution occupational schemes can stay in that arrangement and need not be automatically enrolled into an occupational scheme.

2.32 European legislation prohibits automatic enrolment into personal pensions. The Government is considering whether employers with qualifying workplace personal pension arrangements should be exempt from the duty to automatically enrol new employees and those who are not members of the scheme, under certain prescribed conditions.

### ***Defined benefit schemes***

2.33 A defined benefit pension scheme is an occupational scheme where the pension is related to the member’s salary or some other value fixed in advance.

2.34 Defined benefit schemes contracted out of the State Second Pension which hold a reference scheme test certificate<sup>58</sup> will qualify to be used for automatic enrolment. Contracted-in schemes and formerly contracted-out schemes which provide a minimum accrual of 1/120<sup>th</sup> (on each year’s pensionable service), based on the simplified principles of the reference scheme test, will also qualify to be used for automatic enrolment.

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<sup>58</sup> The reference scheme test is a test of overall scheme quality that defined benefit schemes must satisfy, if the sponsoring employer chooses to contract out of the State Second Pension (S2P). A scheme that passes the reference scheme test is expected (but not guaranteed) to provide pensions broadly equivalent to or better than the benefits that the individual is giving up from contracting out of S2P.

### ***Hybrid schemes***

- 2.35 Hybrid schemes contain elements of both defined benefit and defined contribution occupational schemes.
- 2.36 Employers with hybrid schemes will be directed to the test which most closely matches their scheme, whether defined benefit, defined contribution or an appropriate combination. Guidance will be provided to help employers apply the appropriate test.

### ***Default investment mechanism***

- 2.37 Qualifying schemes will not be permitted to require members to actively make an investment choice. This avoids the situation where contributions cease if an individual is automatically enrolled into a scheme, and does not opt out, but fails to make an active choice of fund.

### ***Deferral periods***<sup>59</sup>

- 2.38 The June 2007 response to the consultation set out the Government's position that automatic enrolment should take place immediately a worker becomes eligible. Allowing employers to defer their duty to automatically enrol eligible workers could adversely affect certain groups of workers, particularly those who change jobs frequently, and casual or seasonal workers. These individuals would see a reduction in their pension income if they were unable to participate in pension saving for the first three months of each employment.
- 2.39 However, where employers offer a defined benefit scheme, or make contributions higher than the minimum employer contribution requirement for defined contribution schemes, there will be an exception to allow employers to defer enrolment. The Bill will enable us to limit the deferral period to three months to ensure that those who remain in work will quickly make up forgone savings. The deferral period is designed to support employers in maintaining higher value provision.
- 2.40 The level of contributions required to qualify for the deferral period will be defined in secondary legislation. The expectation is that the level will be set such that it:
- rewards employers offering contributions significantly above the minimum; and

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<sup>59</sup> The term 'deferral period' is used in this document in place of the term 'waiting period' which has been used in previous published documents. This is to clarify that the deferral period constitutes a deferral of the employer requirement to undertake enrolment. The term 'waiting period' commonly refers to a scheme rule which restricts eligibility. The legislation will not impose any direct restrictions on employers' ability to agree a scheme-specific waiting period with their scheme: in discharging the new requirements the employer retains choice about what package of provision best meets their needs.

- enables individuals to accrue, relatively quickly, equal or better savings than if they had saved in the personal accounts scheme.

2.41 In allowing some employers to defer enrolment, we recognise that this could leave workers who work only for short periods at risk of receiving lower contributions overall and lower pension incomes as a result. Conversely where workers remain with employers who offer higher contributions or benefits, they will gain from higher levels of savings as a result. Further analysis on the options considered for deferral periods is set out in Appendix 1 to this chapter.

## Phasing

2.42 The proposals set out in this chapter will lead to some employers offering pensions for the first time. For those who already offer pensions, it may mean enrolling more workers into their schemes and increasing participation. To help employers and workers adjust to the new requirements, it is our intention to phase in contributions over the first three years in the way shown in the table below. Workers may choose to contribute more, although employers will not be required to match any voluntary contributions.

<b>Table 2.1: Illustration of the three-year phasing option</b>			
	Year 1	Year 2	Year 3
Employer Contribution	1%	2%	3%
Worker Contribution (including tax relief)	1%	3%	5%

2.43 The phasing framework will be set out in the Bill. However, the length of the total phasing period will be put in regulations. We will continue to engage with stakeholders on how to make the phasing period work best for all employers and we will keep the phasing period under review.

2.44 Appendix 1 sets out the analysis we have done to compare the impact of three and five year phasing periods on employer contribution costs and individual savings levels for all qualifying schemes, including personal accounts. Phasing contributions should bring benefits to both employers using defined contribution pension schemes, including personal accounts, and their workers. Phasing will give employers time to adjust to the impact of making pension contributions for all or some of their workforce for the first time. Phasing will also give workers time to adjust to the impact of pension contributions being deducted from their earnings. This should help to reduce any concerns about affordability and result in greater overall participation.

2.45 Phasing contributions is not appropriate for defined benefit schemes, which must comply with minimum funding requirements at all times, and phasing by accruals is prohibitively complex. We have therefore made a decision to allow employers operating defined benefit schemes and relevant hybrid schemes to

phase in automatic enrolment of their workers over the phasing period. This will entail automatically enrolling all new starters and previously ineligible workers from the date the new requirements come into effect. Those individuals who had previously refused membership but remain in the eligible group to enrol must be automatically enrolled by the end of the phasing period, helping employers to manage the cost of enrolment.

## Consultation

2.46 In addition to the formal consultation that followed the publication of the May and December White Papers, Ministers and officials at the Department for Work and Pensions (DWP) have regularly met with representatives of the pensions industry, employers, and consumer groups to explain and consult on these proposals.

2.47 DWP has also carried out an independent evaluation of individuals' and employers' attitudes and likely reactions to these reforms, comprising nationally representative surveys of almost 2,400 private sector employers and over 750 workers who would be eligible for automatic enrolment.

2.48 These surveys reveal strong and broad-based support for automatic enrolment and a minimum employer contribution:

- 64 per cent of individuals were in favour of automatic enrolment<sup>60</sup>. People see this as a good way to overcome inertia and encourage people to save for their retirement<sup>61</sup>;
- 91 per cent of individuals were in favour of an employer contribution; People see an employer contribution as an important incentive to save in a personal account<sup>62</sup>; and
- 58 per cent of employers thought these proposals were a good idea. Employers across all size groups were broadly supportive of these proposals<sup>63</sup>.

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<sup>60</sup> Research by Ipsos MORI for DWP (Smith P, Webb C, Pye J, Robey R, and Jeans D, forthcoming in 2008, *Individuals' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*).

<sup>61</sup> Hall S, Pettigrew N and Harvey P, 2006, *Public attitudes to personal accounts: Report of a qualitative study*, DWP Research Report No 370.

<sup>62</sup> Hall S, Pettigrew N and Harvey P, 2006, *Public attitudes to personal accounts: Report of a qualitative study*, DWP Research Report No 370.

<sup>63</sup> Research by BMRB International for DWP (Grant C, Fitzpatrick A, Sinclair P and Donovan JL, forthcoming in 2008, *Employers' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*).

## Costs and benefits

### Impact on individuals

- 2.49 Automatic enrolment is one of the most effective joining techniques for combating people's tendency not to act when faced with difficult financial decisions. It creates a presumption to save and will make it easier for workers to do so, while retaining the opportunity for them to opt out.
- 2.50 For example, the Employers' Pension Provision Survey 2005<sup>64</sup> shows a link between automatic enrolment and increased levels of pension scheme membership. In private sector firms with 20 or more employees where automatic enrolment was used, the proportion of employees in a pension averaged 60 per cent. This compared with 41 per cent for traditional opt-in.
- 2.51 Automatic enrolment also has the greatest impact among groups where participation rates are low. Evidence from the introduction of automatic enrolment into private pension schemes in the United States showed that automatic enrolment had the largest effect among people on low incomes, including people from minority ethnic groups and women<sup>65</sup>.
- 2.52 Finally, the combination of a minimum employer contribution of 3 per cent, existing tax relief and low charges in the personal accounts scheme will make saving more attractive than ever before for millions of moderate to low earners<sup>66</sup>.

### ***How many new savers?***

- 2.53 These reforms are expected to generate a substantial increase in the number of people saving for a pension. However, at this stage, there is inevitable uncertainty about the exact size of this effect. It will depend on the choices made by millions of individuals and employers when these reforms are introduced, as well as changes in the pensions landscape between now and 2012.
- 2.54 In order to inform policy development, and to understand the possible impact of these reforms on individuals, employers and the financial services industry, the Government has developed a set of working assumptions about the potential number of new savers and where they might be saving.
- 2.55 Initial modelling by DWP, presented in the May and December 2006 Regulatory Impact Assessments, suggested that around 10.8 million employees could be automatically enrolled into a workplace pension scheme and that once

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<sup>64</sup> McKay, S. 2006, *Employers' Pension Provision Survey 2005*, Department for Work and Pensions, research report no. 329.

<sup>65</sup> Madrian and Shea, 2002, in Munnell and Sunden, 2004, *Coming up short. The challenge of 401(k) plans*, The Brookings Institute.

<sup>66</sup> The May 2006 Regulatory Impact Assessments presented a range of UK and international evidence showing an association between employer contributions and participation.

fully rolled out the personal accounts scheme could have between 6 and 10 million members.

2.56 These estimates have now been updated to reflect recent policy developments, including greater clarity on how employers may use existing schemes to fulfil their automatic enrolment duty, as well as the latest evidence on pension trends, employment patterns and individuals' and employers' likely reactions to these reforms. Annex F sets out in detail the methodology and evidence base underlying our latest estimates and compares them with those presented in the May and December 2006 Regulatory Impact Assessments.

2.57 Emerging findings from a survey of individuals who would be eligible for automatic enrolment has provided us with new evidence on individuals' likely participation rates<sup>67</sup>. Almost seven in ten (69 per cent) people said that they would definitely or probably stay in the scheme after being automatically enrolled. This compared to just over two in ten (22 per cent) who said they would definitely or probably opt out. Adjusting for the ages of those most likely to be automatically enrolled, our central estimate is that 75 per cent of people will choose to continue saving once enrolled. This lies within a range between our lower estimate of 55 and upper estimate of 80 per cent.

**Table 2.2: The likely reactions of individuals to being automatically enrolled**

Definitely opt out	Probably opt out	Probably stay in	Definitely stay in	It depends	Don't know
11%	11%	45%	24%	7%	3%

Source: Research by Ipsos MORI for DWP (Smith P, Webb C, Pye J, Robey R, and Jeans D, forthcoming in 2008, *Individuals' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*)

2.58 New evidence<sup>68</sup> also suggests that more employers than previously anticipated are likely to automatically enrol their workers into an existing pension scheme. Around nine in ten employers (87 per cent) making contributions of 3 per cent or more said that they would maintain their current pension scheme for existing members, and four in ten (43 per cent) said that they would enrol all new workers into their existing scheme. Employers who did not offer access to any type of pension scheme were more likely to say they would use personal accounts, although some said that they would choose to set up their own scheme.

2.59 Based on this evidence, and taking account of the uncertainties around how individuals, employers and the finance industry might react, our latest working

<sup>67</sup> Research by Ipsos MORI for DWP (Smith P, Webb C, Pye J, Robey R, and Jeans D, forthcoming in 2008, *Individuals' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*).

<sup>68</sup> Research by BMRB International for DWP (Grant C, Fitzpatrick A, Sinclair P and Donovan JL, forthcoming in 2008, *Employers' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*). This is a nationally representative survey of 2,400 private sector employers across a range of size bands.

assumptions suggest that once these reforms are introduced 9-11 million workers will be enrolled in a workplace pension. This will result in:

- 6-9 million people newly participating or saving more in workplace pensions;
- 4-8 million new savers in workplace pensions;
- 4-7 million individuals participating in personal accounts; and
- 1-2 million additional people saving or saving more in existing pension schemes<sup>69</sup>.

2.60 The Government will continue to update these estimates as new evidence becomes available and as it refines its approach to implementing these reforms.

### ***Other pension savers***

2.61 Although not automatically enrolled into their employer's pension scheme, those earning below £5,000, aged between 16 and 22 or above State Pension age will be able to apply to join their employer's scheme should they wish to do so. Currently, pension participation among these groups is very low. We do not expect this to change significantly following reform as individuals would still need to make an active decision to participate in their employer's scheme.

2.62 The self-employed will be able to join the personal accounts scheme to take advantage of its low charges. However, we expect the number choosing to do so to build up slowly over time. The self-employed will not benefit from an employer contribution and many will already be contributing to a personal pension, or will have an alternative retirement plan, while others will wish to prioritise building up their business. Some of the restrictions we will place on personal accounts, such as a contribution limit, will also make the scheme less attractive to this group than existing products on the market.

2.63 In addition, personal accounts members who have left paid work or go on to work for an employer who does not offer personal accounts will be able to continue to make voluntary contributions into their personal account.

2.64 Taking account of all these groups, we estimate that, eventually, there could be up to around 0.6 million savers in personal accounts who have not been automatically enrolled.

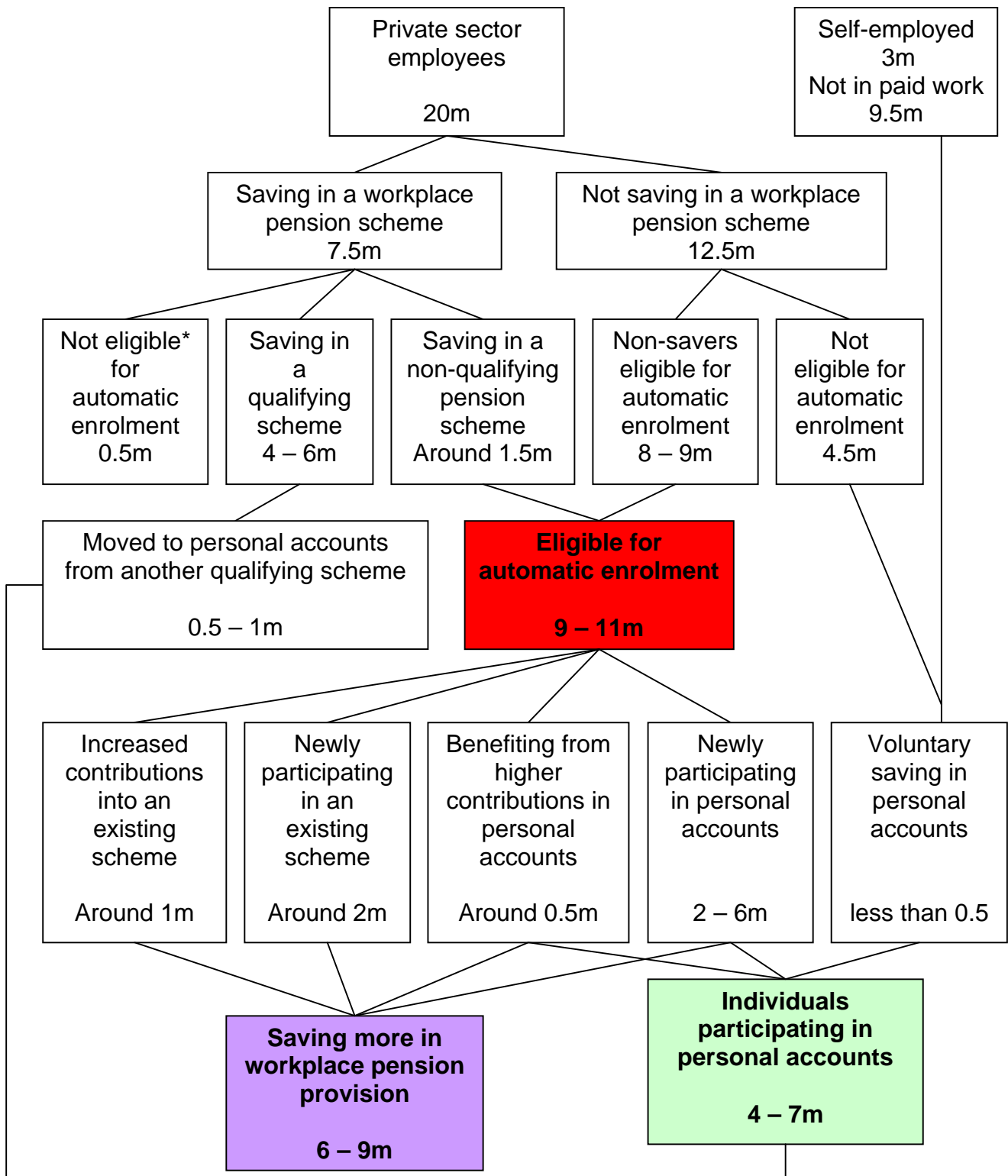
2.65 Figure 2.1 provides a summary of the number of people we expect to be eligible for automatic enrolment and to save in either a personal account or existing workplace scheme in 2012.

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<sup>69</sup> Source: DWP modelling.



Figure 2.1: Working assumptions of pension participation in 2012 (millions)



Source: DWP modelling

Notes: Numbers are rounded to the nearest 0.5 million and therefore may not sum.

\* Not eligible means not aged between 22 and State Pension age or earning less than £5,035 (in 2006/07 earnings terms).

### **Impact on lifetime incomes**

2.66 Automatic enrolment will lead to millions more people saving in a pension, enabling them to transfer income from their working life to boost their income in retirement. As a result many individuals are likely to enjoy increased well-being over their lifetime through an economic concept known as ‘consumption smoothing’. This is explained in more detail in Box 1 below.

2.67 In order to illustrate the scale of this transfer, the table below shows aggregate annual pension contributions from individuals participating in workplace pension schemes following reform. This is based on DWP modelling of the current UK pensions landscape and reflects projected changes in the population and employment as well as earnings growth over time.

<b>Table 2.3: Total individual contributions in future years (£ billion)</b>				
	2020	2030	2040	2050
Individual contributions	5.3	6.5	7.9	9.6

Source: DWP modelling.

Notes: Costs are expressed in 2007/08 prices and are rounded to the nearest £100 million.

#### **Box 1: Consumption smoothing**

In economics, ‘consumption smoothing’ means transferring consumption from a period in someone’s life where they can afford to consume a lot to one where they could afford to consume only a little. In the context of pension saving, this means an individual forgoing a fraction of their income during their working life to have more income in retirement.

The reason why ‘consumption smoothing’ is beneficial is that most people value individual units of consumption, say, a meal in a restaurant, more highly in times when they can afford fewer of them. This is based on the concept of diminishing marginal utility; this says that the additional increase in well-being from an extra unit of consumption falls as individuals consume more of a given item. Hence, transferring some income and thereby consumption from a time with relatively high income (working life) to one with a relatively low income (retirement), can represent a net gain in an individual’s well-being.

Our current working assumption is that following these reforms there will be 6-9 million people saving more for retirement and therefore able to smooth their consumption more effectively. As a result, we would expect society as a whole to feel substantially better off<sup>70</sup>. While this will not be the same as an actual

<sup>70</sup> Layard R, Mayraz G, and Nickell S, 2006, *Marginal Utility of Income*, considers these ideas in some depth and suggests that the assumptions used in our analysis are conservative with respect to the value of redistribution to individuals.

<sup>71</sup> Van de Coevering et al, *Estimating economic and social welfare impacts of pension reform* DWP pensions technical working paper, 2006.

increase in financial wealth, we estimate that this welfare effect could have a magnitude equivalent to several tens of billion of pounds. Based on the methodology set out in the working paper *Estimating economic and social welfare impacts of pension reform*<sup>71</sup> this would be equivalent to at least £40 billion for the period up to 2050.

- 2.68 As well as benefiting from a higher pension income and consumption smoothing, individuals will also benefit from their own default contribution being matched through a combination of the employer contribution and Government tax relief. This will help people to build up their savings more quickly and make saving more attractive than before for many moderate to low earners.
- 2.69 Table 2.4 shows the possible outcomes, in terms of retirement incomes and replacement rates, a set of illustrative individuals might expect from saving at the minimum contribution rate. Someone earning £25,000 who saves from the age of 30 might expect, on average, a gross weekly private pension of £64 and a replacement rate of 45 per cent, in line with the Pensions Commission's recommendation. Those with lower lifetime earnings will achieve higher replacement rates, reflecting the greater State Pension they receive as a proportion of their working age income. Those on higher earnings, or who start saving later, will receive a lower rate of income replacement but would have the option of making additional contributions if they wished.
- 2.70 While the default contribution rates used to illustrate the gains from saving in the table below are a useful foundation, many individuals as well as employers may choose to contribute more. Emerging findings from a survey of individuals' attitudes and likely reactions to personal accounts show that just under half (46 per cent) of those who said they would stay in personal accounts also said they would be likely to contribute above the minimum level of 4 per cent on a regular basis. Of these, more than half (54 per cent) said they would be likely to make contributions of 5 or 6 per cent, around two in ten (21 per cent) said they might contribute between 7 and 9 per cent, and a further two in ten (19 per cent) said they might contribute between 10 and 20 percent<sup>72</sup>.

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<sup>72</sup> Research by Ipsos MORI for DWP (Smith P, Webb C, Pye J, Robey R, and Jeans D, forthcoming in 2008, *Individuals' attitudes and likely reactions to the personal account reforms 2007; Report of a quantitative survey*).

		Age in first year of personal accounts			
		22	30	40	55
Annual earnings*					
£10,000	Gross weekly private pension (£)	20	15	10	3
	Final net weekly Income (£)	177	170	160	154
	Replacement rate with saving (%)	93	89	83	80
	Improvement in replacement rate from saving (%)	9	6	2	1
£15,000	Gross weekly private pension (£)	41	32	20	6
	Final net weekly Income (£)	192	182	171	161
	Replacement rate with saving (%)	68	64	59	56
	Improvement in replacement rate from saving (%)	12	9	5	1
£20,000	Gross weekly private pension (£)	62	48	30	9
	Final net weekly Income (£)	207	196	182	169
	Replacement rate with saving (%)	56	52	48	44
	Improvement in replacement rate from saving (%)	13	10	6	1
£25,000	Gross weekly private pension (£)	83	64	40	12
	Final net weekly Income (£)	226	208	192	178
	Replacement rate with saving (%)	50	45	41	38
	Improvement in replacement rate from saving (%)	15	11	7	2
£30,000	Gross weekly private pension (£)	104	80	50	15
	Final net weekly Income (£)	244	222	202	188
	Replacement rate with saving (%)	45	41	36	34
	Improvement in replacement rate from saving (%)	16	12	7	2
£35,000	Gross weekly private pension (£)	123	95	59	18
	Final net weekly Income (£)	261	236	211	198
	Replacement rate with saving (%)	42	37	33	31
	Improvement in replacement rate from saving (%)	17	13	7	2

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

Notes:

\* Annual earnings are expressed in 2007/08 earnings terms.

- The figures are based on the age of the individual in 2012 (22, 30, 40 and 55);
- The illustrative individuals are assumed to start work at age 25 (except for the first individual who starts work at age 22) and work up to State Pension age which is not necessarily the same for all the individuals in the table;
- They save from 2012 until State Pension age at the default rate with a charge equivalent to a reduction in yield of 0.5 per cent, with phasing of contributions over three years. It is assumed the fund is lifestyled and that the individual takes and annuitises the tax-free lump sum;
- Replacement rates are calculated using the formula: gross income including any benefit entitlements in the 1<sup>st</sup> year of retirement divided by gross earnings in the final year of work; and
- The figures include Council Tax Benefit entitlement with or without saving, with the full weekly liability assumed to be £16 in 2007.

### ***The decision to save***

- 2.71 Most people will aspire to a higher retirement income than the state alone can provide, yet many millions of people are currently making insufficient provision for their retirement.
- 2.72 These reforms will mean that, subject to factors such as investment returns, annuity rates and length of retirement, individuals at the point of automatic enrolment can generally expect the net increase in their retirement income to be greater than the total value of their contributions, plus inflation. This means that people can generally expect to get back more in real terms than they put in, as well as benefiting from consumption smoothing and avoiding an unexpected and unwelcome drop in their income in retirement.
- 2.73 If individuals decide not to save for retirement they will lose out on their employer contributions and potential investment returns, and are highly likely to have a lower income in retirement than if they had saved.
- 2.74 However saving in a pension will not be the right thing for every individual all of the time. Some may already have made sufficient provision for their retirement. Others may have other priorities, such as reducing debt. Some individuals may require more help from the state than others through income related benefits. A person's pension contributions are taken into account (wholly or partly) in some Tax Credit and benefit calculations – so the cost of the contribution to individuals receiving these benefits is likely to be partially offset by higher benefit payments. Similarly, in retirement, any savings or income will be taken into account when calculating any benefit entitlement<sup>73</sup>, so those with higher private income may have lower benefit entitlement.
- 2.75 The state benefit system provides a safety net, guaranteeing a minimum level of income for those unable to build up sufficient state entitlement or who need extra support such as the disabled or those with caring responsibilities. Most people will aspire to have more than the minimum provided by the state, while anyone who chooses to rely on income-related benefits is making assumptions about what the benefit system might look like 20, 30 or 40 years from now. Reforms in the Pensions Act 2007 mean that those who spend at least half of their life working or caring – including low earners – will be taken above the standard Pension Credit entitlement. In addition, the savings reward in Pension Credit and the lump sum and trivial commutation rules<sup>74</sup> mean that many of those who do end up with some income-related benefit entitlement may still see a benefit from saving and an increase in income that exceeds the value of their contributions.

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<sup>73</sup> Note that, though up to £6,000 of capital is disregarded in Pension Credit, Housing Benefit and Council Tax Benefit calculations and pension savers may benefit from this through the ability to take a lump sum or trivially commute.

<sup>74</sup> 25% of a pension fund can be taken as a lump sum, and in addition those with a pension fund of up to £16,000 can take the whole amount as a lump sum under 'trivial commutation' rules.

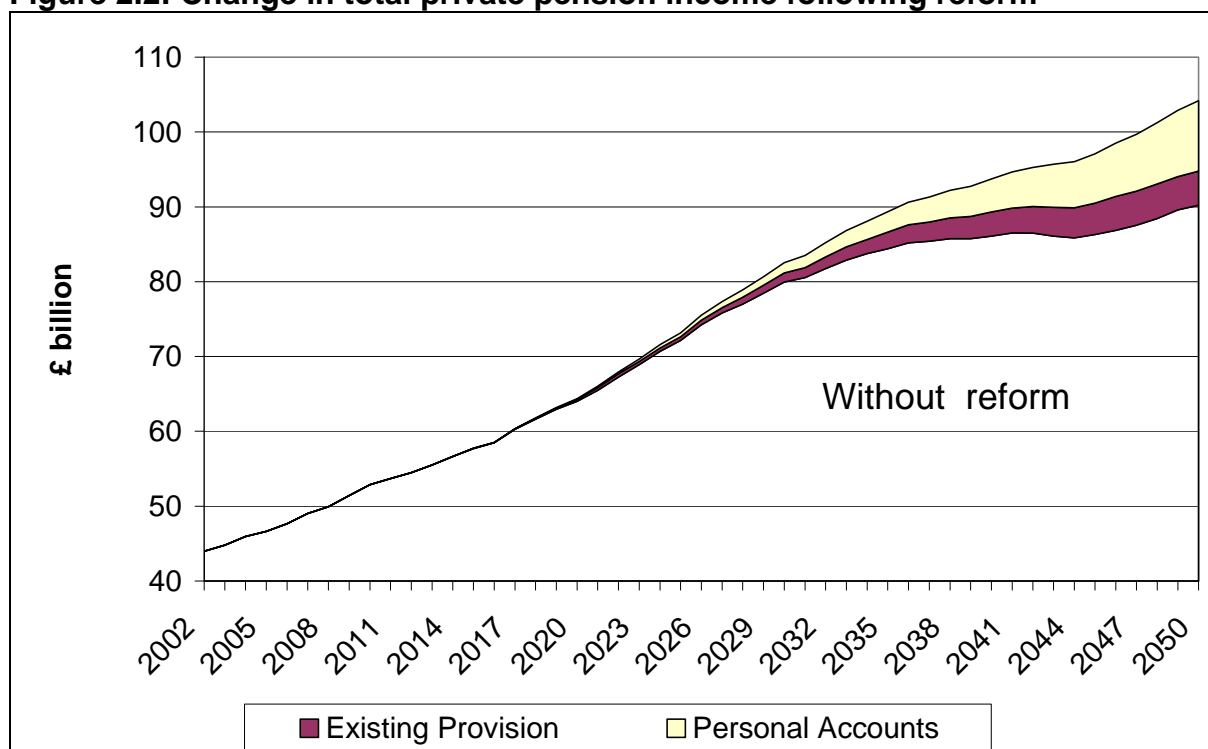
2.76 Analysis by the DWP<sup>75</sup> shows that, taking all these factors into account, most people at the point of enrolment can expect good returns on their saving. However the Government recognises that individuals will need good information to help them decide whether to opt out of saving and will ensure appropriate information is available, based on sound research with both individuals and stakeholders.

### **Impact on aggregate private pension incomes**

2.77 Using the DWP's Pensim2 model<sup>76</sup>, we have modelled the impact of automatic enrolment, a minimum employer contribution and the personal accounts scheme on future retirement incomes. Our projections suggest that by 2050 this could result in a rise of 12 per cent in the average private pension income received by young pensioners (those aged from 68 to 75 in 2050).

2.78 In total, these reforms will increase private pension incomes by around £11-16 billion a year by 2050 (2007/08 prices), or £5-7 billion in earnings 2007/08 terms. Figure 2.2 depicts an increase in private pension incomes in the central scenario.

**Figure 2.2: Change in total private pension income following reform**



Source: DWP modelling using the Pensim2 model

Notes: Figures are shown in 2007/08 prices.

<sup>75</sup> DWP, *Financial Incentives to save for retirement*, published November 2006, [Hwww.dwp.gov.uk/pdfs/financialincentives.pdf](http://www.dwp.gov.uk/pdfs/financialincentives.pdf).

<sup>76</sup> Pensim2 is a model developed by the Department for Work and Pensions that simulates the future life course of a current population sample to estimate their future pension income. It enables aggregate and distributional analysis of alternative policy, demographic and economic scenarios. It is based on data from the Family Resources Survey (FRS), British Household Panel Survey (BHPS) and Lifetime Labour Market Data Base (LLMDB). For more details see Appendix F of the Pensions Commission Second Report, *A new pensions settlement for the twenty-first century*, published in 2005.

## Impact on employers

2.79 The Government's reform programme continues to place employers at the heart of pension provision, and can only be successful with the support and involvement of employers. Many employers in the UK are already making a substantial contribution to pension schemes and are supporting their workers to save for retirement. However, in order to meet the challenges identified by the Pensions Commission, those employers who do not already support pensions also need to play a role.

2.80 The duty on employers to automatically enrol jobholders into a qualifying workplace pension arrangement and make minimum contributions will lead to an increase in aggregate contribution and administrative costs.

2.81 The size of these costs will depend on the nature of the employer's current provision and how they intend to fulfil their new duties:

- approximately 670,000 employers currently offer no provision and so will need to offer a qualifying workplace pension arrangement and enrol all jobholders;
- approximately 240,000 employers currently offer some provision but make less than a 3 per cent employer contribution. These employers will need to increase their contribution rate in their existing scheme or open an alternative qualifying workplace pension scheme; and
- approximately 300,000 employers offer a contribution greater than 3 per cent. These employers will need to extend their provision to ensure that all jobholders have access to the minimum employer contribution<sup>77</sup>.

2.82 The majority of additional employer costs will be incurred by those employers who do not currently provide a workplace pension with an employer contribution.

2.83 At this stage, the precise costs to employers of these reforms are difficult to estimate. This is partly because the number of workers brought into saving is itself subject to a considerable degree of uncertainty, as explained in paragraphs 2.53 – 2.60. It is also because the detailed design processes relating to how automatic enrolment and personal accounts will work have, rightly, not yet been finalised. In taking forward this work the Government and the Personal Accounts Delivery Authority will continue to work with employers and gather evidence on the economic context within which these reforms will be introduced to ensure they can achieve their aims whilst minimising burdens on employers.

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<sup>77</sup> DWP internal analysis of Small and Medium-Sized Enterprise Statistics 2006 and the DWP survey of employer attitudes: research by BMRB International for DWP (Grant C, Fitzpatrick A, Sinclair P and Donovan JL, forthcoming in 2008, *Employers' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*).

### Contribution costs

2.84 In the December 2006 Regulatory Impact Assessment, DWP estimated the cost of the minimum employer contribution to be £2.8 billion, within a range from £1.7 billion to £3.8 billion. These costs have since been updated to reflect new evidence on employers' and individuals' likely reactions to the reforms<sup>78</sup>, as well as the latest data on employment and earnings.

2.85 If employers were only to make the minimum 3 per cent contribution for their eligible workers, our latest estimate is that the value of additional employer contributions would be approximately £2.5 billion once contributions have been fully phased in. This is within a range of £1.8 billion to £2.9 billion. This represents a slight reduction in total labour costs from 0.7 per cent to 0.6 per cent when compared to the estimates presented in the December 2006 Regulatory Impact Assessment. Table 2.5 presents these estimates by firm size.

<b>Table 2.5: Additional costs to employers of minimum contributions, once contributions have been fully phased in (£ million)</b>			
	Central estimate	Estimated range	Percentage of labour cost
Large firms	1,000	700 to 1,100	0.5%
Medium firms	400	300 to 400	0.6%
Small firms	800	600 to 900	0.9%
Micro firms	400	300 to 400	1.1%
<b>Total</b>	<b>2,500</b>	<b>1,800 to 2,900</b>	<b>0.6%</b>

Source: DWP modelling based on Employers' Pension Provision Survey 2005, SME statistics 2005, Annual Survey of Hours and Earnings 2005, DWP survey of employer attitudes: research by BMRB for DWP (Grant C, Fitzpatrick A, Sinclair P and Donovan JL, forthcoming in 2008, *Employers' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*) and DWP survey of individual attitudes: research by Ipsos MORI for DWP (Smith P, Webb C, Pye J, Robey R, and Jeans D, forthcoming in 2008, *Individuals' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*).

Notes:

- Figures are expressed in 2007/08 earnings terms.
- Figures have been rounded to the nearest £100 million and therefore may not sum.

2.86 Nearly half of the cost of employers making a minimum contribution will fall on micro and small firms, because they are most prevalent and are less likely to currently offer a pension with a contribution of 3 per cent or more. However, even for the very smallest firms, the estimated increase in contributions will be equivalent to only 1.1 per cent of total labour costs.

2.87 Employers will have several ways of managing these additional costs. Emerging research suggests that employers would be most likely to absorb the

<sup>78</sup> DWP survey of employer attitudes: research by BMRB International for DWP (Grant C, Fitzpatrick A, Sinclair P and Donovan JL, forthcoming in 2008, *Employers' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*).



increase as part of overhead costs<sup>79</sup> (28 per cent), through increased prices (21 per cent), or through lower wage increases (14 per cent)<sup>80</sup>. Depending on the mechanism chosen by the employer, some of these headline costs could be dampened by either a reduction in corporation tax paid or lower employer National Insurance contributions than would otherwise have been payable. This is set out in more detail in the section on *Impact on Government* below.

- 2.88 Some employers may also choose to contribute more than the minimum, recognising contributions to a pension scheme as a useful recruitment and retention tool. The Government recognises that some employers might wish to offset part of the increased cost of contributions by reducing their current contribution rate. It is difficult at this stage to estimate the scale of this possible effect. Our latest evidence on employer reactions to the reforms is outlined in paragraphs 2.109-2.111.
- 2.89 Based on our latest assumptions on how employers might fulfil their duties, our current estimate of the total net increase in employer contributions resulting from these reforms is £2.9 billion, within a range of £1.4 billion to £4.1 billion, once contributions have been fully phased in. This represents around 0.7 per cent of total labour costs.
- 2.90 Table 2.6 shows what might happen to employer contribution costs over time if the increase discussed in paragraph 2.89 remained constant but increased in line with earnings growth. These estimates are used in the cost benefit analysis that appears in the summary.

<b>Table 2.6: Total annual employer contributions in future years – central scenario (£ billion)</b>				
	2020	2030	2040	2050
Employer contributions	4.4	5.4	6.6	8

Source: DWP modelling

Notes: Costs are expressed in 2007/08 price and are rounded to the nearest £100 million.

### **Administrative costs**

- 2.91 In the December 2006 White Paper, the Government announced that it was setting up a cross-government group of experts to improve its understanding of the cost impact of these reforms on employers. This work has now been completed and a summary of the group's conclusions can be found in Annex G. As a result of this work, we have updated our estimates of the administrative cost to employers of these reforms.

<sup>79</sup> This may include profits.

<sup>80</sup> Research by BMRB International for DWP (Grant C, Fitzpatrick A, Sinclair P and Donovan JL, forthcoming in 2008, *Employers' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*).

2.92 The findings from this work will be used to inform the detailed design and implementation of automatic enrolment and the personal accounts scheme to ensure employer burdens are minimised.

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

- preparing for start-up: includes setting up internal systems and adjusting IT and payroll processes;
- registration and qualification: includes training staff and deciding how the firm will meet its new legal duties;
- worker enrolment: includes registering workers with the qualifying scheme; and
- collection and administration: includes the monthly collection process and adjustments to payslips.

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

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

2.95 The administrative cost to employers will also depend on the way they choose to fulfil the new duties. This could be via the personal accounts scheme or via another qualifying scheme, which could be the employer's existing scheme or a new one.

2.96 Table 2.7 shows our updated estimates of total administrative costs to all firms, whether they automatically enrol jobholders into the personal accounts scheme or use an alternative qualifying scheme.

<b>Table 2.7: Total additional administrative cost to all firms, by firm size (£ million) <sup>81</sup></b>		
	Year 1 cost	Ongoing cost in future years
Large firms	37	6
Medium firms	34	6
Small firms	105	28
Micro firms	167	59
Single person director firms	8	2
<b>Total costs</b>	<b>350</b>	<b>101</b>

Source: DWP modelling

Note: Figures are expressed in 2007/08 earnings and prices

2.97 Compared to the December 2006 Regulatory Impact Assessment, our latest estimate of the set-up costs of these reforms have been revised upwards by approximately one fifth in year one (£350 million compared to £291 million) and by 5 per cent in future years (£101 million compared to £96 million). This reflects changes in our methodology, rather than additional requirements on employers, the most significant of which are:

- updated wage estimates and the inclusion of the non wage costs of employment;
- more robust estimates of the costs of collecting monthly contributions, including the cost to firms that outsource their payroll obligations; and
- a clearer understanding of how employers will choose to fulfil their employer duty, in particular an increase in the number of employers we expect to use a qualifying scheme other than personal accounts.

2.98 More detail on the nature and effect of these methodological changes can be found in Annex G.

2.99 Within the aggregate figures presented above, we estimate that those employers who choose to fulfil their new duties by extending their existing scheme will have lower administrative costs than those setting up a new qualifying scheme. This is because the majority of employers setting up a new scheme will not benefit from having pre-existing systems and experience of

<sup>81</sup> The cost of each employer registering with TPR is included in these cost estimates. A small number of compliant employers may have further dealings with the compliance body, for example if they are selected for investigation on the basis of a risk profile determined by employer characteristics. This additional contact is not included in our admin cost estimates because it is not clear how many compliant employers will be affected and so we don't have a robust enough cost estimate yet.

dealing with pension contributions. The majority of those setting up a new scheme will use personal accounts.

2.100 Table 2.8 below shows the average administrative cost per firm:

<b>Table 2.8: Average administrative cost per firm, by firm size</b>			
	Number of firms	Cost in Year 1 (£)	Ongoing cost in future years (£)
Large firms	6,000	6,200	1,100
Medium firms	27,000	1,300	200
Small firms	371,000	300	80
Micro firms	800,000	200	70
Single person director firms	254,000	30	10
Average cost for all firms	1,458,000	200	70
Average cost for all firms (excluding single person director firms)	1,204,000	300	80

Source: DWP modelling

Notes:

- Costs are expressed in 2007/08 earnings (where functions involve staff time and are measured by wages) and price terms;
- Numbers of firms have been rounded to the nearest 1,000;
- Year 1 costs have been rounded to the nearest £100, where the figure is less than £100 it has been rounded to the nearest £10;
- Ongoing costs in future years have been rounded to the nearest £100, where the figure is less than £100 it has been rounded to the nearest £10.

2.101 Although the costs of these reforms per firm are greatest for large firms, their share of the total administrative cost and their cost per employee is estimated to be much smaller. This reflects the fact that most firms are small and that most small firms do not already provide a pension with an employer contribution. Small firms are also likely to have to enrol a larger proportion of their workforce into a pension scheme.

2.102 A number of small employers and representative groups have suggested that small employers may require more help than larger employers in adjusting to their new duties and have called for financial support. The Government recognises that the smallest businesses will have the most difficulty in managing the additional costs. At this stage, the Government is focused on ensuring that the design of personal accounts scheme is appropriate before any further support for employers is considered. This would be a decision for future Governments based on the fiscal position at the time.

2.103 The Government is committed to minimising the costs of these reforms for firms and is taking a number of measures to help them adjust to the new requirements being placed on them:

- a commitment to phasing in both employer and jobholder contributions;
- designing straightforward qualifying tests for existing schemes;
- allowing employers offering higher contribution schemes to operate deferral periods; and
- a proportionate but effective compliance regime.

2.104 In addition, we will continue to consult with employer groups as we take these proposals forward towards the implementation phase.

### **Impact on existing pension schemes and products**

2.105 The existing pension market suffers from a number of market failures. People who are aware of their need to save for retirement do not save due to inertia and a short-term approach to saving and consumption. By introducing automatic enrolment and a minimum employer contribution, we will boost the number of pension savers. Overall, this will have a beneficial impact on the financial services industry, including pension providers, fund managers and third party administrators. This is explored in more detail in the competition assessment in Annex B.

2.106 Some stakeholders have expressed a concern that firms currently providing good pension schemes could reduce or 'level down' their contribution levels to the minimum requirements as a way of managing the cost of these reforms or because the minimum employer contribution level comes to be seen as the 'norm'. If this were to be widespread, it would reduce the increase in pension incomes described earlier.

2.107 The Government recognises this risk and is therefore taking a number of measures to mitigate it, including a deferral period for employers offering higher contributions and simple qualifying tests for existing schemes. It is also taking measures to ensure that the personal accounts scheme is targeted at the part of the market not well-served by existing schemes, for example by setting an annual contribution limit. These reforms should also be viewed against a long-term trend of employers retreating from workplace pension provision where there is currently no minimum entitlement.

2.108 The Government regards this as an important issue and will continue to review the evidence on levelling down and monitor trends amongst employers and within the pensions industry as we approach 2012.

2.109 As outlined in paragraph 2.90, emerging findings show that employers have several ways of managing the additional costs, with most reporting that they

would be most likely to absorb them through overhead costs<sup>82</sup>, prices and wages<sup>83</sup>. Furthermore, support for the Government's reforms was particularly strong among employers who were already making contributions of 3 per cent or more – nearly three-quarters (74 per cent) of these employers said that they thought the Government's reforms were a good idea.

2.110 Of those employers who make contributions of 3 per cent or more, the vast majority (86 per cent) reported that they would maintain or even increase contribution levels for existing members. Only 6 per cent reported they would be likely to reduce contributions for existing members and these tended to be the smaller employers.

2.111 About half (51 per cent) of employers contributing 3 per cent or more said that they would offer new employees their existing contribution levels or even higher. This compares to three in ten employers (30 per cent) who said that they might provide contributions to new workers that were less than those to existing employees. However, it tended to be smaller employers who said this - an analysis of employers with five or more employees shows that 64 per cent of employers contributing 3 per cent or more plan to offer their existing contribution levels or even higher to new employees, and only 17 per cent say they might consider not extending this level of provision to all employees. It is important to remember that without the Government's reforms some of these people may not otherwise have had access to or joined a pension scheme.

### ***Workplace personal pension arrangements***

2.112 The personal accounts scheme is being introduced to address a specific market failure. The Government is therefore keen to see existing good quality pension provision continue and recognises the important role of workplace personal pensions within the current pensions market. In 2005, 3.3 million employees were members of workplace personal pensions, of which 2.1 million were receiving employer contributions of 3 per cent or more<sup>84</sup>. The value of total contributions into workplace personal pensions was around £6.7 billion in 2006/07<sup>85</sup>.

2.113 However, European legislation<sup>86</sup> prohibits the use of automatic enrolment into contract-based financial services, such as personal pensions. There will be no duty on employers to automatically enrol individuals *already in* existing workplace personal pension arrangements that meet the defined contribution qualifying test into another scheme instead. However, employers will not be able to automatically enrol new eligible workers into these schemes from 2012. Thus the

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<sup>82</sup> This may include profits.

<sup>83</sup> Research by BMRB International for DWP (Grant C, Fitzpatrick A, Sinclair P and Donovan JL, forthcoming in 2008, *Employers' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*).

<sup>84</sup> DWP analysis of the Employers' Pension Provision Survey 2005 and the Annual Survey of Hours and Earnings 2005.

<sup>85</sup> HMRC, Pensions statistics, Tables 7.4 and 7.5,

<http://www.hmrc.gov.uk/stats/pensions/menu.htm>

<sup>86</sup> The Distance Marketing Directive and the Unfair Commercial Practices Directive.

key question is how, for enrolment purposes, to treat new workers and those who have not previously joined a workplace personal pension arrangement or, from 2012, join an employer offering such an arrangement.

- 2.114 Achieving high levels of pension participation is central to the Government's private pension reforms. As discussed in paragraph 2.50-2.51 above, research suggests that automatic enrolment is one of the most effective ways of overcoming individual inertia when faced with difficult financial decisions and is therefore likely to lead to relatively high levels of pension participation. For this reason the Government is keen to preserve the principle of automatic enrolment.
- 2.115 A solution on how to treat workplace personal pensions beyond 2012 therefore involves striking an appropriate balance between maintaining the principle of automatic enrolment in order to maximise participation in pensions and minimising impact on good workplace personal pension arrangements as well as the burden on employers. The Bill includes a power enabling the creation of regulations allowing for employers with workplace personal pensions to be exempted from the requirement to automatically enrol eligible workers. We are working closely with our stakeholders and undertaking detailed analysis on how such an exemption could work in practice.

### ***Impact of scheme rule changes***

- 2.116 Employers can choose to automatically enrol their workers into a scheme other than the personal accounts scheme so long as it meets the qualifying criteria described in paragraphs 2.26-2.37.
- 2.117 Before this can happen, the trustees and sponsoring employer of each occupational pension scheme will need to review the current scheme rules to determine if the qualifying criteria are met. If the scheme meets the qualifying criteria the employer can then automatically enrol their workers into the existing scheme. If not, then the trustees and the employer will need to agree to change the rules of the scheme, or to automatically enrol their workers into a qualifying scheme.
- 2.118 DWP has estimated the cost of reviewing the rules and making the required changes of all open occupational schemes to be £60 million in the run up to reform.

### **Impact on the wider economy**

#### ***Financial markets***

- 2.119 The Government's central estimate is that a policy of automatic enrolment and personal accounts would generate pension savings of up to about £10 billion per year by 2015, based on our estimate of 6-9 million people saving, or saving more, in workplace pensions. Approximately 60 per cent of these savings are expected to be additional, equivalent to just less than half of one per cent of Gross

2.120 The impact on financial markets of such a savings increase is likely to be limited. To provide some context, the current stock of pension savings is estimated to be around £1,400 billion.<sup>88</sup> We estimate that there might be around £100–300 billion funds under management in personal accounts by 2050 in 2007/08 earnings terms.

### **Macroeconomy**

2.121 In 2006, the DWP commissioned the National Institute of Economic and Social Research (NIESR) to simulate the effect of the introduction of these reforms on the macro-economy<sup>89</sup>. The effect on economic growth was estimated to be small in all the scenarios considered.

2.122 In the short term, higher savings will slow down consumption<sup>90</sup>. This in turn will have a very small downward effect on economic growth in the first few years after introduction. In the central scenario, the combined impact of these lower growth years remains below 0.2 per cent of Gross Domestic Product. After this period, growth rates recover and the level of Gross Domestic Product returns to where it would otherwise have been. In the long run, the extra savings will result in incomes rising by around 0.2 per cent as measured by Gross National Product due to the extra investment income received from abroad<sup>91</sup>. These impacts are illustrated in Figure 2.3 below.

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<sup>87</sup> John Hawksworth, PricewaterhouseCoopers, 2006, *Review of research relevant to assessing the impact of the proposed National Pensions Savings Scheme on household savings*, DWP Research Report No 373.

<sup>88</sup> UBS Global Asset Management, *Pension Fund Indicators 2006*.

<sup>89</sup> Coevering, van de, et al. 2006, *Estimating economic and social welfare impacts of pension reform*, DWP Pensions technical working paper.

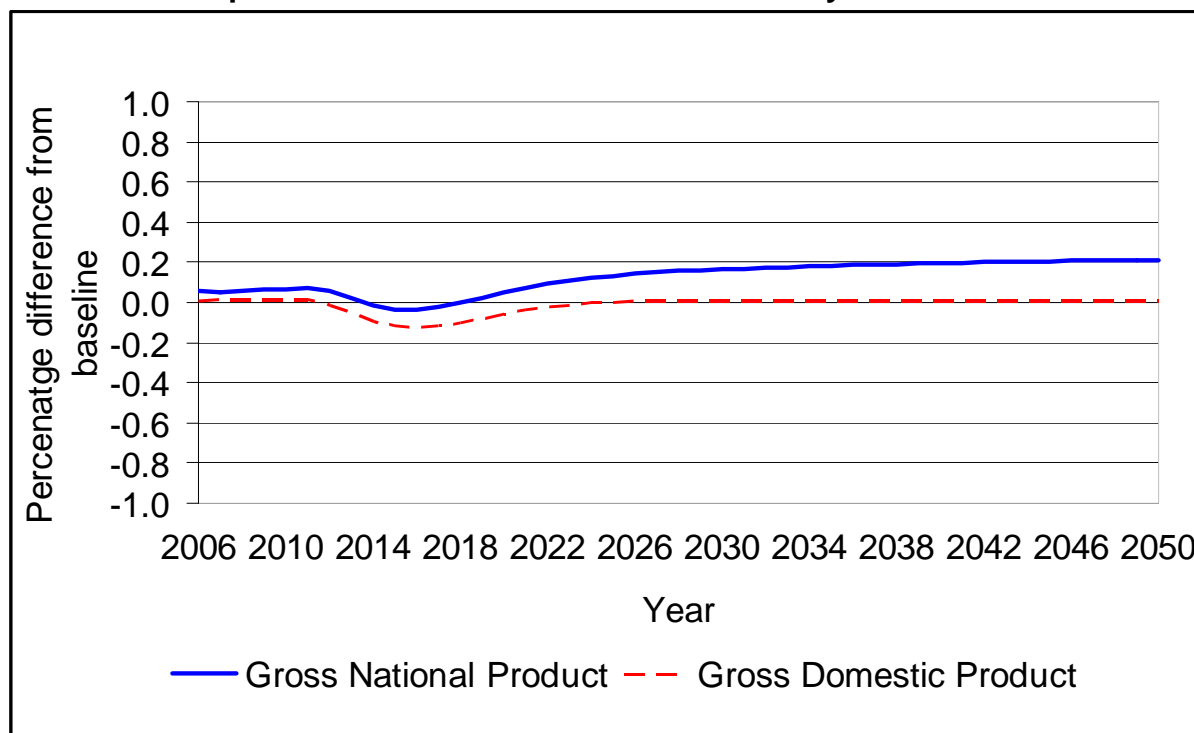
<http://www.dwp.gov.uk/pensionsreform/pdfs/DWPTechWorkingPaper.pdf>

<sup>90</sup> Although the NIESR analysis assumed slightly higher increases in pension saving than our current working assumption, it was broadly similar and therefore we do not expect its conclusions to be markedly different.

<sup>91</sup> The extra income would be generated as UK residents increased their ownership of domestic and foreign companies and other assets that they invest in through their pension funds. The ownership of these assets would generate returns which would ultimately allow people in the UK to spend more.



Figure 2.3: The impact of the reforms on economic activity



Source: National Institute of Economic and Social Research (NIESR).

Note: The figure shows the difference in percentage points compared to the base case for the central modelling scenario.

## Impact on government

### Tax relief

2.123 The tax system offers an incentive to save for retirement by providing tax relief on individuals’ pension contributions. The increase in saving resulting from these reforms will increase the cost of this support. As tax relief is given at an individual’s marginal rate of taxation, we would expect the majority of the extra relief to be given at the basic rate. The cost to the Exchequer of the extra tax relief given to individual contributions is estimated to be around £1 billion in 2014 when contributions have been fully phased in<sup>92</sup>. Table 2.9 below sets out the additional cost of tax relief due to the introduction of the duty to automatically enrol workers over time:

Table 2.9: Total additional annual cost to Government of tax relief in future years (£ billion)				
	2020	2030	2040	2050
Cost of tax relief	1.3	1.6	2.0	2.4

Source: DWP modelling.

Notes: Costs are expressed in 2007/08 prices and are rounded to the nearest £100 million.

<sup>92</sup> DWP modelling based on data from the Employers Pension Provision Survey 2005 and the Annual Survey of Hours and Earnings (ASHE) 2005. Figures are expressed in 2007/08 prices.

2.124 Some of this extra tax relief will be offset by higher tax receipts from future pension incomes. As an illustration, HM Revenue and Customs data shows that around 40 per cent of the expenditure on tax relief is offset by tax on pensions paid in the same year<sup>93</sup>. This figure is illustrative and might change in the future.

2.125 The employer contribution could also have an impact on the Exchequer. If the contribution were funded out of company profits there would be a reduction in corporation tax paid, and if it were funded through reduced wage growth the Exchequer would forego employee income tax and National Insurance contributions from both employer and employee. The impact on the Exchequer of these tax offsets is estimated to be between £0.7 and £1.5 billion in 2014<sup>94</sup>. There are also some potential second order effects of the increase in saving on value added tax (VAT) and spending on tax credits, but these have not been quantified here.

### ***Income-related benefits***

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

2.127 Assuming that the current benefit rules continue to apply, the increase in private pension saving due to these reforms would be expected to lead to less reliance on income-related benefits in retirement. By 2050 around £250 million<sup>95</sup> (2007/08 prices) less might be spent on Pension Credit, equivalent to 4 per cent of projected expenditure on Pension Credit. This compares to £11-16 billion extra generated in additional private pension income in the same year.

2.128 Individuals may also be eligible to receive Housing Benefit or Council Tax Benefit. By 2050 around £400 million<sup>96</sup> (2007/08 prices) less might be spent on Housing Benefit and Council Tax Benefit as a result of the additional private pension income generated by the reforms. This would be equivalent to 3 per cent of projected expenditure on Housing Benefit and Council Tax Benefit in that year.

### ***National Insurance Fund payments***

2.129 There is likely to be a further cost to Government from employers that become insolvent while owing contributions to a pension fund. Existing legislation governing occupational pension schemes makes provision for the National Insurance Fund to pay outstanding pension contributions in certain cases when an employer becomes insolvent. The reforms will increase the number of

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<sup>93</sup> HMRC Statistics Table 7.9, 40% is an average over the past 9 years. The data compare the tax on pensions paid in the year, not the tax that might eventually be received on pension paid as a result of contributions made in the year.

<sup>94</sup> Using the methodology set out in Appendix E of the May 2006 Regulatory Impact Assessment.

<sup>95</sup> Rounded to the nearest £50 million.

<sup>96</sup> Rounded to the nearest £50 million.

employers making contributions, so will increase the cost of this provision. The estimated extra cost is around £30 million per annum.

## Implementation and delivery plan

2.130 The successful implementation of this policy requires that employers know their duties and can access a qualifying pension scheme. The compliance regime will act as the safety net that ensures employers do in fact meet their duties, without imposing unreasonable burdens upon compliant employers in the process.

2.131 An effective marketing and communication strategy will be used to ensure that employers know and understand what is required of them, and when.

2.132 The pensions industry has been consulted at an early stage in the design of the reforms, and pension providers will receive information and guidance to help them prepare for the reforms, so that they are able to provide a qualifying pension scheme if they wish.

**Competition impact** – see Annex B

**Gender impact** – see Annex C

**Race impact** – see Annex D

**Disability impact** – see Annex E

## Appendix 1: Options analysis for deferral periods and phasing

### Analysis of deferral periods<sup>97</sup>

#### *Universal deferral period*

1. Enabling all employers to operate a deferral period, that is to delay automatic enrolment by any length of time, would reduce burdens on employers, particularly those with high numbers of temporary or short-term staff. However, this would come at the expense of reduced final pension fund sizes for individuals, particularly those who move jobs often. The longer the deferral period, the greater these effects, as demonstrated below.

#### *Impact on individuals*

2. The lack of contributions during deferral periods affects final fund sizes and the income generated from the reforms. Over a 40-45 year working life individuals, on average, change jobs around 8 times<sup>98</sup>. Table 2.10 shows the impact of deferral periods of different lengths on the final fund size if an individual were to change jobs eight times in their lifetime.<sup>99,100</sup>

Table 2.10: Reduction in fund sizes given 8 job moves a lifetime	
Deferral period	% reduction in fund size
None	0%
3 months	5%
6 months	9%

Source: DWP modelling

<sup>97</sup> The term 'deferral period' is used in the document in place of the term 'waiting period' which has been used in previous published documents. This is to clarify that the deferral period constitutes a deferral of the employer requirement to undertake enrolment. The term 'waiting period' commonly refers to a scheme rule which restricts eligibility. The legislation will not impose any direct restrictions on employer's ability to agree a scheme-specific waiting period with their scheme: in discharging the new requirements the employer retains choice about what package of provision best meets their needs.

<sup>98</sup> Source: Labour Force Survey.

<sup>99</sup> We assume each job is with an employer operating a deferral period. Individuals spending some time in other pension schemes with no deferral period would see a smaller reduction.

<sup>100</sup> Figures are based on a median earner (£22,000) who saves for 40 years facing an Annual Management Charge of 0.5% and whose job moves are spread evenly over their working life. Job moves that are concentrated early in an individual's career make only a small difference to these results.

3. Some individuals will change jobs much more frequently than this. A six-month deferral period for someone changing jobs 16 times over their lifetime would cut their fund size by over 20 per cent.

### ***Impact on employers***

4. Table 2.11 below shows the estimated savings for employers as a result of a deferral period of varying lengths.

**Table 2.11: The reduction in employer contributions and employer administrative costs of allowing a universal deferral period in personal accounts**

Deferral period	Contributions (£ million)	As a percentage of total annual contributions costs	Administrative savings (£ million)	As a percentage of total estimated administrative costs
3 months	119	4.0%	2 – 5	2.1 – 5.3%
6 months	248	8.3%	3 – 8	3.2 – 8.5%

Source: DWP analysis based on Employers' Pension Provision Survey 2005, Small and Medium-Sized Enterprise (SME) Statistics 2005, Annual Survey of Hours and Earnings 2005 and Labour Force Survey 2006

Notes:

- Contributions are rounded to the nearest £5 million;
- Administrative savings are based on savings from not having to automatically enrol individuals who leave before the deferral period is over;
- Administrative cost savings are rounded to the nearest £ million and are in 2006/07 prices;
- The cost of enrolling one worker into personal accounts is estimated to be between £3.50 and £9, dependent on whether the employee works for a small or large firm and whether they opt out or not.

5. While the general policy remains that there will be no universal deferral period, there will be an exception to this. We recognise that employers who are voluntarily paying higher contributions, or providing higher benefits, are concerned about the increased costs that the duty to automatically enrol will create. Furthermore, the Government wishes to reward such employers in order to encourage them to continue these provisions.

### **Limited deferral period for employers offering higher contributions or benefits**

#### ***Defined contribution qualifying schemes***

6. In order to qualify for a deferral period, qualifying schemes will be required to provide a higher employer contribution than the minimum of 3 per cent. We have considered a range of options, including:
  - 10 per cent employer contribution: this option sets the level of total employer contribution at 10 per cent such that a worker would recover the 3 per cent

employer contribution lost under a three month deferral period within six months (which includes the three-month deferral period);

- 6 per cent employer contribution: this option sets the level of total employer contribution at 6 per cent such that a worker would recover the 3 per cent employer contribution lost under a three-month deferral period within nine months (which includes the three-month deferral period);
- Median contribution (7 per cent): this option uses the current median level of employer contributions into a defined contribution scheme (7 per cent) such that employers of half the total defined contribution membership would be able to access the deferral period. It also means that a worker would recover the 3 per cent employer contribution lost under a three-month deferral period within eight months (which includes the three-month deferral period).

7. The level of the defined contribution required to operate a deferral period will be set in secondary legislation. Tables 2.12 and 2.13 below provide a summary of the contribution benchmark assessment.

Table 2.12: Summary of contribution benchmark assessment			
Contribution benchmark	Catch up period (includes 3 months deferral period)	Number of employees adversely affected by deferral period*	% of eligible employees affected by deferral period
10%	6	5,000	1.4%
7%	8	10,000	1.8%
6%	9	13,000	2.0%

\* The adverse affect stems from an employee leaving employment before they are able to recoup savings.

Source: Labour Force Survey, January-March 2007 and Employers’ Pension Provision Survey 2005, private sector only.

Note: Numbers are rounded to the nearest 1,000.

**Table 2.13: Savings for employers offering higher contributions and enjoying a three-month deferral period, once contributions have been fully phased in**

Contribution level	10%	7%	6%
Number of eligible employees covered by employer offering higher contributions	60,000	90,000	110,000
Contribution cost with no deferral period (£ million)	290	340	360
Contribution savings due to 3 month deferral period (£ million)	130	140	150
Admin cost saving (£ million)	0.2-0.3	0.2-0.3	0.2-0.3

Source: DWP modelling based on data from the Employers' Pension Provision Survey 2005, SME statistics 2005, Annual Survey of Hours and Earnings 2005, DWP survey of employer attitudes: research by BMRB for DWP (Grant C, Fitzpatrick A, Sinclair P and Donovan JL, forthcoming in 2008, *Employers' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*) and DWP survey of individual attitudes: research by Ipsos MORI for DWP (Smith P, Webb C, Pye J, Robey R, and Jeans D, forthcoming in 2008, *Individuals' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*).

### ***Deferral period for defined benefit qualifying schemes***

8. Based on existing data, most defined benefit schemes have at least an accrual rate of 1/80th<sup>101</sup>. Setting the accrual rate for deferral period eligibility at 1/80th would capture just over 95 per cent of the membership of defined benefit schemes – assuming there are no changes to the defined benefit landscape. Furthermore, 1/80th is as good as, or better than, the minimum requirement in personal accounts.
9. Offering all qualifying defined benefit schemes a deferral period would be administratively simple to operate and would not impose an additional burden on employers. Furthermore, given the general decline in the membership of private sector defined benefit schemes, a deferral period may not adversely affect as many employees as it would for defined contribution qualifying schemes.

### **Analysis of a phasing period**

10. The following tables show the impact of three- and five-year phasing periods on employer costs and individuals fund sizes for both personal accounts and qualifying schemes. They demonstrate that, particularly for older workers, a longer phasing period can have a relatively high impact on their pension funds.

<sup>101</sup> National Statistics, *Occupational Pension Schemes 2006* survey shows 97% of active members of defined benefit schemes with an accrual rate of 1/80<sup>th</sup> or better.

Table 2.14 below shows the costs to employers of both a three and five-year phasing period.

<b>Table 2.14: Costs to employers of a three or five-year phasing period</b>					
Total contribution	Year 1	Year 2	Year 3	Year 4	Year 5
3 year phasing (£ million)	1,100	2,100	3,000	3,000	3,000
5-year phasing (£ million)	1,100	1,100	2,100	2,100	3,000

Source: DWP modelling based on Employers' Pension Provision Survey 2005, SME statistics 2005, Annual Survey of Hours and Earnings 2005, DWP survey of employer attitudes: research by BMRB for DWP (Grant C, Fitzpatrick A, Sinclair P and Donovan JL, forthcoming in 2008, *Employers' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*) and DWP survey of individual attitudes: research by Ipsos MORI for DWP (Smith P, Webb C, Pye J, Robey R, and Jeans D, forthcoming in 2008, *Individuals' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*).

11. Table 2.15 compares the impact on pension fund sizes using the same phasing in periods.

<b>Table 2.15: Impact on pension fund sizes of proposed phasing and 5-year phasing</b>				
Age of individual in 2012	Pension fund size	Pension fund size with proposed phasing (£)	Pension fund size with 5-year phasing (£)	Effect on fund size of 5-year phasing compared to proposed phasing (%)
25	79,000	76,000	73,000	-3.2%
40	42,000	39,000	38,000	-4.4%
55	15,000	13,000	12,000	-9.9%

Source: DWP modelling

Notes:

- The illustrative individuals are assumed to work and save up to State Pension age which is not necessarily the same for all the individuals in the table;
- They save from 2012 until State Pension age at the default rate for median earners with a charge equivalent to a reduction in yield of 0.5 per cent. It is assumed the fund is lifestyled and that the individual takes and annuitises the tax-free lump sum.



# Chapter 3: Extending access to simple, low-cost saving: personal accounts

## Objectives

- 3.1 In order to ensure that all workers, particularly our target group of moderate to low earners, have access to a simple, low-cost pension scheme, the Government will set up a defined contribution occupational pension scheme: personal accounts.
- 3.2 There are five key principles that continue to drive this work:
- simplicity: the personal accounts scheme must simplify the decisions people are asked to make about their retirement provision and provide an easy way to save;
  - independence: the personal accounts scheme will be delivered using private sector expertise, independent of outside pressures;
  - working for members: building a personal accounts scheme which commands the confidence of its members and is designed with their needs at its heart;
  - minimising the burden on employers: ensuring that the impact on employers is considered at each stage of development of the personal accounts scheme; and
  - supporting good existing provision: focusing the personal accounts scheme on those without access to good workplace schemes.

## Rationale

- 3.3 The reforms outlined in Chapter 2 will make it easier and more attractive for individuals to save in a pension. This will help to tackle the problem of insufficient demand that exists within the current pensions market. However, without further reform, there would still be a supply gap in the current market which means that a significant number of moderate to low earners and those working for small employers would not have access to low-cost pension saving.
- 3.4 The nature of these groups means they are less able to make large pension contributions and less likely to save for a prolonged period due to uneven

employment patterns<sup>102</sup>. This can make it difficult for pension providers to cover the high upfront costs of marketing and selling pension products. As a result, providers tend to actively target those with higher earnings or who work for large employers, where the higher revenues and economies of scale they require can be more easily achieved. This also means charges on personal pensions can be relatively high; while few personal pensions are sold below the stakeholder charge cap of 1.5 per cent of funds under management, many occupational pensions charge 0.4-1 per cent.

- 3.5 This effect is compounded by inefficient competition in this segment of the market. Those on moderate to low incomes typically have a poor understanding of pensions and therefore do not exert effective pressure on providers to reduce costs or improve quality<sup>103</sup>. The same problem does not occur in occupational pension schemes where trustees, supported by professional advisors, can act as informed customers on behalf of members to achieve better value from providers.
- 3.6 Personal accounts will address these supply side failures by ensuring all employees and employers have access to a simple, low-cost pension scheme.

## Consultation

- 3.7 In addition to the formal consultation that followed the May and December 2006 White Papers, Ministers and officials have continued to engage with stakeholders on the details of these reforms. Following the May 2006 White Paper, the Department for Work and Pensions (DWP) held a series of seminars with interested parties on aspects of the personal accounts scheme. In July 2007 we held a seminar with employers and employers' representative organisations to discuss employer compliance. The Pensions Policy Institute were co-sponsored by the DWP and others to explore stakeholders' views on the role of the Personal Accounts Delivery Authority, and held a seminar on the charging structures for the personal accounts scheme.

## Summary of proposals

- 3.8 This section sets out how the Government is taking forward proposals relating to introduction of the personal accounts scheme, as proposed in the May 2006 White Paper and set out in more detail in the December 2006 White Paper. This will be delivered using the National Pension Savings Scheme model recommended by the Pensions Commission<sup>104</sup>.
- 3.9 The private sector has both significant experience and expertise in delivering large occupational pension schemes. The Government is therefore keen to

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<sup>102</sup> The persistency of personal pensions has been falling in recent years. This is documented in a recent survey by the Financial Services Authority, *Survey of the Persistency of Life and Pensions Policies, 2007*; available online at [Hwww.fsa.gov.uk/pubs/other/Persistency\\_2007.pdf](http://www.fsa.gov.uk/pubs/other/Persistency_2007.pdf)

<sup>103</sup> The Sandler Review of Medium and Long-term Retail Investment, July 2002, found that competitive forces did not always work to deliver value and charges for near-identical products could vary widely.

<sup>104</sup> The Pensions Commission, 2005, *A New Pension Settlement for the Twenty-First Century*.

ensure private sector involvement from an early stage. We have already started to bring in private sector expertise through the creation of the Personal Accounts Delivery Authority and the appointment of Paul Myners and Tim Jones as its Chair and Chief Executive. This process will continue through to the establishment of an independent trustee corporation to run the scheme from 2012.

3.10 This approach has been widely supported and there is consensus amongst stakeholders that this is the best way to build credibility and public confidence in the new scheme.

### **Personal Accounts Delivery Authority**

3.11 As we have previously announced, the Government intends to establish the personal accounts scheme in three stages:

- stage 1 – setting up a Personal Accounts Delivery Authority (the Authority) to provide expert advice to Government on the operational implications of the policy and to develop a commercial and procurement strategy to inform policy development;
- stage 2 – extending the remit and powers of the Authority so that it can take on responsibility for implementing the personal accounts scheme (including the commercial and procurement strategy, designing, building and testing systems, and securing people and premises) within a framework set by legislation; and
- stage 3 – handing over the day to day running and strategic management of the personal accounts scheme to the trustee corporation. In practice there will be a period of overlap between stages 2 and 3 to ensure continuity during the transition and to ensure the trustees can take responsibility for strategic decisions such as investment.

3.12 Powers taken in the Pensions Act 2007 implemented the first of these stages.

3.13 For the second stage, this Bill allows for the broadening of the Authority's remit and asks for powers to enable it to oversee the establishment of the personal accounts scheme. This will allow the Authority to enter into formal negotiations, finalise contracts, and manage the specification and development of the systems needed before the scheme can go-live. The Authority will also continue to have a role in advising and making recommendations on the key features and strategic direction of the scheme.

3.14 The Authority's main functions in the second stage will be:

- Overseeing the establishment of the personal accounts scheme; and
- Working with the Pensions Regulator to develop the infrastructure for the employer compliance regime.

3.15 In discharging its functions, the Authority will be required to have regard to the following guiding principles, as outlined in the June 2007 White Paper response document:

- minimising the burden on employers;
- minimising the impact on other high-quality pension provision;
- optimising levels of participation and contribution among the target group;
- delivering low charges to members;
- providing an appropriate range of fund choices; and
- acting in an open and consultative manner.

3.16 It is important that in taking forward the personal accounts scheme, the Authority and the trustee corporation are given the flexibility to deliver and run a low-cost scheme that is commercially sustainable whilst meeting the needs of its members. This means not taking detailed decisions now that these organisations will be better placed to make in the future. Instead, this Bill will ensure that there is a framework within which these decisions will be made.

### **The personal accounts scheme**

3.17 The personal accounts scheme will be set up as a trust-based, defined contribution occupational pension scheme. This approach offers protection for members, through the combined weight of trust law and existing pensions legislation, and places a legal duty on the trustees to act in members' interests. It also gives trustees, rather than government, responsibility for the scheme's strategic direction.

3.18 In common with other occupational pension schemes, the personal accounts scheme will be regulated by the Pensions Regulator. It will not itself be a regulating body. Scheme members will have access to the normal routes of redress in the event of a complaint.

3.19 This Bill includes measures to set up the personal accounts scheme as a trust-based scheme. These measures also enable the establishment of the trustee corporation which will administer the scheme.

3.20 The scheme order and scheme rules will form the trust deed. The scheme order will be in secondary legislation and will be debated in both houses of Parliament. The order will set out the main provisions of the scheme and will only be changed with the approval of Parliament. The rules are likely to contain the more operational and administrative details of the scheme. They will not be debated by Parliament but will be published in draft and comments invited from interested parties. Once the rules have been agreed, the trustees must run the

scheme in the best interests of its members, within the terms of the order and rules.

3.21 Following the creation of the personal accounts scheme, the trustees will be required to set up a members' panel and an employers' panel. The trustees must consult with these panels about the operation and development of the scheme. This includes the trustees consulting with both members' and employers' panels before proposing or consenting to any changes to the scheme order or rules. The intention is that these panels will act as a conduit for gathering opinion and will ensure that both members' and participating employers' interests are taken into account in the running of the scheme. It is also the intention that the members' panel will nominate one third of the trustees.

### **Decisions for the Personal Accounts Delivery Authority and the trustee corporation**

3.22 The Secretary of State will delegate to the Authority responsibility for implementation – engaging their skills, knowledge and expertise to oversee the specification, design, procurement and build of the infrastructure for personal accounts. This will include the fund management and administration systems necessary for the trustee corporation to run the scheme. In these areas, the Authority will have independence and autonomy.

3.23 The scheme order and rules will set out the details of the scheme. The Secretary of State will set the scheme order and rules, but the Authority will take the lead and, through its consultative work be seen to take the lead, in their design and development. While the Authority cannot itself make legislation, it will be the Authority's recommendations which the Secretary of State must consider before coming to a decision which may be expressed in legislation.

3.24 The Authority's role will also be to advise the Secretary of State in areas relating to finance, charging, enrolment and enforcement. Additionally, it will advise on the creation of the members' and employers' panels for the scheme and how their consultation and nomination process for these panels will work.

3.25 The trustee corporation will run the scheme, in the best interests of its members, within these rules.

### **Funding**

3.26 As part of its extended role, the Authority will need to consider how finance is raised for the design, set up and any early years' operating deficits of the scheme.

3.27 In the long-term, it is intended that the personal accounts scheme will be self-financing through revenue raised from membership charges. However, in the short term, until there are sufficient members in the scheme, its costs will exceed likely revenues. For example, before the scheme is established, the Authority will need to pay for set-up and administration costs relating to the implementation of the scheme as well as entering into contracts with private providers to deliver the scheme.

- 3.28 The Government's intention is for firms involved in the design, set-up and operation of the scheme to be selected through competitive tender to ensure maximum value from the market. However, the Government recognises that the personal accounts scheme will be operating in an area where the market has, to date, failed to deliver effective provision for some. The scheme will be required to accept employers with any eligible worker, without any assessment or consideration of the level of contributions that would flow as a result of scheme membership. In addition, maximum contribution levels will restrict the scheme from competing with other pension providers for higher earning individuals. This raises a number of challenges in managing risk and meeting the set-up and any early years operating deficits.
- 3.29 The Authority is currently advising on the design of the scheme and its implications for the cost of building the scheme. The overall cost of the personal accounts scheme will not be finalised until the Authority has completed the commercial procurement process. This cannot take place until some time after the Bill has received Royal Assent. The Government is unable to publish its current estimate of the cost of the scheme for reasons of commercial confidentiality and the potential risk that this could influence future negotiations.
- 3.30 The short term financing requirement will depend on the cost of setting up and operating the scheme in its early years, and the revenue from membership charges. The Authority will consult on the structure of the charging regime before making recommendations to the Secretary of State.
- 3.31 The Government is taking broad powers in the Bill to ensure that the Authority has sufficient flexibility to develop a finance strategy that balances value for members and commercial viability, and recognises the constraints of fairness and affordability when implementing public policy.

## **Charges**

- 3.32 Through the personal accounts scheme, the Government aims to provide people with a simple low-cost way of saving for a pension. However, decisions on charges should generally be for those responsible for running the scheme. This will ensure charges are both sufficient to cover scheme costs as well as being attractive to both existing and future members.
- 3.33 The Bill will allow the Authority, as part of its extended role, to design and make recommendations to the Secretary of State on the charge structure and level. This will include whether additional charges should be levied to cover the cost of certain services, for example frequent change of fund choice or complex information requests. The Authority will also be responsible for drafting the scheme rules relating to when charges should be applied, when they should cease, when refunds are due and what rules should apply when there have been over or underpayments. In making these recommendations the Authority will be required to have regard to the principle of delivering low charges to members.

3.34 Once the scheme is established, the trustee corporation will assume day-to-day responsibility for determining charges in accordance with its objective of acting in members' best interests.

### Investment

3.35 Investment decisions are a key consideration for any pension scheme. Like other trust-based occupational pension schemes, investment decisions in the personal accounts scheme will be the responsibility of the scheme's trustees who will possess the relevant skills, knowledge and expertise.

3.36 The Authority will be tasked with developing an initial Statement of Investment Principles for consideration and approval by the trustees responsible for investment decisions, who will be appointed prior to the scheme's launch.

3.37 Investment funds offered by the personal accounts scheme will be chosen in the best interest of future members and after consultation with those in the target group. Personal accounts scheme members who do not wish to make a fund choice will have their contributions automatically invested into a default fund. We also expect the scheme to offer a wider choice of investment funds. Personal accounts funds will be managed by professional, independent, fund managers recruited in line with industry practice.

### Decumulation

3.38 The personal accounts scheme will be subject to the same decumulation rules as other tax registered pension schemes. Most members will be able to take up to 25 per cent of their personal accounts savings as a tax-free lump sum and convert the remainder to an annuity which will provide them with an income for life. Members who have accumulated small private pension savings may be able to convert their savings to a lump sum under the normal trivial commutation rules.

3.39 The Government recently carried out a review of the operation of the Open Market Option and at Pre-Budget Report 2007 announced a series of measures to improve the decisions made by consumers<sup>105</sup>. The personal accounts scheme will follow the best practice as set out in the Open Market Option review, including the requirement to offer the Open Market Option, enabling individuals to shop around for the best deal.

3.40 Within this overall framework, recommendations on the detailed decumulation process will be made by the Authority to the Secretary of State. From 2012, the decumulation process will be managed by the trustees.

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<sup>105</sup> The full list of measures can be found at [http://www.hm-treasury.gov.uk/media/7/5/pbr\\_csr07\\_omo74.pdf](http://www.hm-treasury.gov.uk/media/7/5/pbr_csr07_omo74.pdf).

## Supporting existing pension provision

3.41 The personal accounts scheme will have a number of features designed to ensure that it remains targeted at moderate to low earners who do not have access to good quality workplace pension provision. Targeting the scheme in this way will help to ensure that employers who currently provide good quality pensions will continue to do so.

### *An annual contribution limit*

3.42 The Government proposed in its June 2007 consultation response a limit on annual contributions into the personal accounts scheme of £3,600 (in 2005 earnings levels). This will strike a balance between targeting personal accounts at those parts of the market currently under-served and providing individuals with sufficient flexibility to achieve their retirement goals. This limit will be uprated in line with average earnings growth from 2005.

3.43 The Government continues to consider setting a higher contribution limit of £10,000 in the first year. This would help to encourage saving prior to the introduction of personal accounts by giving individuals the opportunity to move non-pension savings into the new scheme when it commences in 2012. We also recognise that individuals may at certain points in their lives wish to invest one-off lump sum contributions into their personal account. The introduction of a lifetime lump sum contribution limit will be subject to evidence that there is sufficient demand for such a measure within the personal accounts' target group, that it can be delivered without undermining the objectives of the annual contribution limit and can be done in a way that is cost effective.

### *Transfer policy*

3.44 There will be a general prohibition on the transfer of pension funds between personal accounts and alternative pension products. This will help ensure that the personal accounts scheme is focused on serving the needs of its target market.

3.45 There will be a limited number of specific circumstances where individuals will be allowed to move funds into and out of personal accounts. One such circumstance is where an individual moves jobs from an employer who offers a qualifying scheme to an employer offering personal accounts before their rights under the first scheme have vested<sup>106</sup>. In this situation, individuals will be allowed to transfer their accrued funds into personal accounts. These funds are known as 'cash transfer sums' and do not count towards the maximum amount that an individual can contribute to their personal account.

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<sup>106</sup> Many occupational schemes pension schemes require a member to be in pensionable service for a period of time before their rights vest. Here we refer to this period as the 'pre-vesting period'. Legally this period cannot be longer than 24 months, although schemes can decide to have shorter periods, or no pre-vesting period at all. During this period, contributions are collected from members and invested. However, if a person leaves a scheme before their rights vest, they are entitled to receive a refund of their contributions. Once a person's rights have vested, these funds cannot be accessed until retirement.



3.46 Additionally, a personal accounts member or a former spouse of a personal accounts member may use personal accounts to discharge a pension credit if they wish. A pension credit, in this context, is the share of a pension arrangement awarded to a former spouse on divorce. Once discharged into the personal accounts scheme, the transfer prohibition applies and the pension credit benefit may not be moved out of the personal accounts scheme into another scheme.

### ***The 2017 review***

3.47 The prohibition on transfers and the annual contribution limit will be reviewed in 2017 when the wider market impacts of these measures are better understood. The review will cover primarily the annual contribution limit and the policy on transfers, but may also include other issues which are relevant at the time.

### **Collection**

3.48 Although the Bill does not include any specific provision relating to the collection of contributions into the personal accounts scheme, the Government recognises that this is an issue of concern for many employers. We recognise that in making payments to the personal accounts scheme, employers will want to use existing infrastructure and processes where possible. In that context, pay as you earn (PAYE) has been identified by some stakeholders as an obvious choice.

3.49 As set out in detail in the June 2007 response to consultation, PAYE is not currently suitable as the collection mechanism because of the delay between deducting payments and attributing them to individual accounts. Working with the Authority, the Government will continue to review the options for a collection process that can be delivered from 2012 and that reflects the challenges for employers in complying with new requirements. The objective will be to align with employer processes as far as possible and to be compatible with existing payroll processes and systems, best practice and IT functionality.

3.50 The Authority has commissioned an independent review of collection options for the personal accounts scheme and a summary of its findings is due to be published in the New Year.

### **Costs and benefits**

3.51 The current pensions market is failing for many of those on moderate to low earnings or who work for small firms. The introduction of the personal accounts scheme will provide these individuals with access to a simple low-cost workplace pension. As a trust-based occupational pension scheme, personal accounts will be run in the interests of its members.

## Impact on individuals

### *Increase in saving*

3.52 As outlined in chapter 2, we estimate that around 4-7 million people will be saving in a personal account once the scheme is fully up and running. This will lead to a significant boost to these individuals' retirement income. Table 2.4 in Chapter 2 illustrates the increase in retirement income an individual might receive by saving in the personal accounts scheme.

### *Low charges*

3.53 The aim of the personal accounts scheme is to provide its target market with a low-cost way to save for their retirement. Low charges can be achieved in the personal accounts scheme because it will benefit from economies of scale, lower marketing costs due to automatic enrolment, and because members can continue making contributions to the scheme even if they change jobs or have periods out of employment. As a result the scheme will offer members low charges, currently only available to those in large occupational pension schemes or those who are able to make high contributions.

3.54 Lower charges can make a significant difference to a person's final pension income. For example, an annual management charge of 0.5 per cent compared to 1.5 per cent over an individual's working life could mean a 25 per cent increase in the eventual size of their fund<sup>107</sup>.

3.55 There are a number of different charging structures in the current pensions market. There is no quantitative information on which structure is the most prevalent, although anecdotal evidence suggests that the approaches include:

- annual management charges;
- contribution charges;
- joining charges;
- flat fees; or
- a combination of any of these.

3.56 The December 2006 White Paper identified a number of attributes that an ideal charging structure should fulfil, including simplicity, fairness and supplying significant revenue for the scheme in the early years. No single charge structure or combination of charging structures could fully meet all these attributes<sup>108</sup>. Instead, trade-offs have to be made.

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<sup>107</sup> DWP modelling.

<sup>108</sup> Pensions Policy Institute, March 2007, *Charging Structures for Personal Accounts*.

- 3.57 Different charging structures can have different effects on individuals, with some groups benefiting more from certain structures than others. The impact can vary depending on a person's earnings, age and savings history. For example, a contribution charge is better for those with intermittent saving, whereas an annual management charge is better for those who start saving relatively early and continue doing so throughout their working lives. The structure of the charge can also affect the balance of costs borne by those who continue to make contributions and those who do not (i.e. those with dormant accounts).
- 3.58 The choice of charging structures could also have an impact on how the personal accounts scheme is financed. Some charging structures may raise more revenue in the scheme's early years, thereby reducing the amount of finance that has to be raised to cover the shortfall in the set up stage and early years of the scheme.
- 3.59 The Authority will consider what charge structure is appropriate for the personal accounts scheme and will consult widely on the issues raised.

### **Investment**

- 3.60 The introduction of automatic enrolment and the personal accounts scheme will mean that many people become involved in long-term investment for the first time. In order to make this transition as easy as possible, the personal accounts scheme will have a default investment mechanism for those individuals who do not wish to make a choice of investment. Evidence shows, however, that many people in the target group would like to be offered a wider choice of funds.
- 3.61 As with other trust-based occupational pension schemes, investment decisions will be the responsibility of the scheme's trustees. The Government expects this will include a structured choice of funds that meets the needs of its target audience in order to optimise participation whilst keeping charges low.
- 3.62 Emerging findings from a survey of individuals' attitudes and likely reactions to personal accounts shows that the majority of the group eligible for automatic enrolment (68 per cent) report that they are in favour of having investment choice with a default fund option and a similar proportion (seven in ten) said they would definitely or probably make such a choice<sup>109</sup>. However, evidence from UK stakeholder schemes and the Swedish Premium Pension plan shows that in practice, the great majority of people leave their money in the default fund<sup>110,111</sup>.

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<sup>109</sup> Research by Ipsos MORI for DWP (Smith P, Webb C, Pye J, Robey R, and Jeans D, forthcoming in 2008, *Individuals' attitudes and likely reactions to the personal account reforms 2007; Report of a quantitative survey*).

<sup>110</sup> CRA International, November 2006, *Branded choice in Personal Accounts*.

<sup>111</sup> Cronqvist & Thaler, 2004, *Design choices in privatized social-security systems: Learning from the Swedish experience* Papers and Proceedings of the 116<sup>th</sup> Annual Meeting of the American Economic Association.

3.63 US evidence shows that participation in pension schemes is higher when there are fewer funds to choose from<sup>112</sup> and in-depth research indicates that people find investment decisions difficult and feel that choice should be limited<sup>113</sup>.

### ***Decumulation***

3.64 The costs and benefits from the decumulation of personal accounts members' pension savings will not differ in type from the costs and benefits experienced by other pension savers.

3.65 The personal accounts scheme will be subject to the same tax rules as other pension schemes and members will be entitled to access the annuity Open Market Option.

3.66 As a result of the recommendations from the recent Open Market Option review, it is expected that more pension savers, including those in personal accounts, will make more informed decisions about their annuity purchase and consequently achieve better outcomes from their pension savings. Annuity income could be up to 20 per cent higher if someone purchases from the best priced provider<sup>114</sup>.

### **Impact on employers**

3.67 The Government's aim is to maximise participation in workplace pension schemes whilst minimising the burdens on employers. In line with this objective, the personal accounts scheme will set up an employers' panel with a remit to advise the trustees on the administrative impact on business and to act as a conduit for employers' views. There will also be ongoing consultation with employers during the design phase.

3.68 Personal accounts will be one option that employers can use to fulfil their new duties. Our latest estimate is that employers using personal accounts will face a total administrative cost of £300 million in the first year of set-up and £89 million in subsequent years. The methodology and assumptions behind these estimates are described in more detail in Annex G.

### **Impact on industry**

3.69 The personal accounts scheme has been designed as far as possible to complement existing pension provision. It will provide individuals and employers who are currently not well served by the pensions market with access to a workplace pension. To ensure that the personal accounts scheme is targeted

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<sup>112</sup> Iyengar, Jiang & Huberman, 2003, *How much choice is too much? Determinants of individual contributions in 401(k) retirement plans* Working paper presented at the Wharton Pension Research Council.

<sup>113</sup> Hall S, Pettigrew N and Harvey P, 2006, *Public attitudes to Personal Accounts: Report of a qualitative study*, DWP Research Report No 370.

<sup>114</sup> Source: Financial Services Authority comparative tables, available online at [www.fsa.gov.uk/tables](http://www.fsa.gov.uk/tables)

effectively, we have introduced a number of measures to minimise any possible impact on the existing pensions industry. These include setting an annual contribution limit and a general prohibition on transfers between the personal accounts scheme and alternative pension vehicles. The impact of these measures is explored in more detail below.

3.70 The personal accounts scheme will also offer new business opportunities to the financial services industry, including scheme administrators, fund managers and annuity providers, who will be able to compete for contracts to deliver the scheme. Procurement processes will follow European Union public procurement rules and legislation on competition. Best practice will be adhered to throughout and all contracts will be let in accordance with the Public Contracts Regulations (2006)<sup>115</sup>.

3.71 The impact of the introduction of the personal accounts scheme on competition in affected markets is set out in detail in the Competition Assessment in Annex B.

### ***An annual contribution limit of £3,600***

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

3.73 As the contribution limit is a fixed amount, it will mostly constrain those with higher earnings or in receipt of a generous employer contribution. Evidence on individual savings behaviour shows that only 13 per cent of those earning between £15,000 and £30,000 made contributions over £3,600 in 2005<sup>116</sup>. A median earner would have to make contributions at least 9 percentage points above the total default contribution rate of 8 per cent before they were constrained by the limit of £3,600. Any individual affected could save in other ways in addition to their personal account.

3.74 Emerging findings from a survey of individuals' attitudes and likely reactions to personal accounts suggests that of those who said they might stay in personal accounts, 46 per cent were likely to contribute above the minimum on a regular basis. However, analysis shows that overall only very few (3 per cent)<sup>117</sup> of those who said they would stay in personal accounts would be likely to exceed the £3,600 annual contribution limit<sup>118</sup>.

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<sup>115</sup> <http://www.opsi.gov.uk/si/si2006/20060005.htm>

<sup>116</sup> Annual Survey of Hours and Earnings 2005.

<sup>117</sup> This excludes a small minority who said they might like to contribute the occasional additional lump sum.

<sup>118</sup> Research by Ipsos MORI for DWP (Smith P, Webb C, Pye J, Robey R, and Jeans D, forthcoming in 2008, *Individuals' attitudes and likely reactions to the personal account reforms 2007; Report of a quantitative survey*).

3.75 As such, although the contribution limit may constrain the savings behaviour of some in personal accounts it has been set at a level that will enable the vast majority of people in personal accounts to save in line with their aspirations.

### ***Transfers***

3.76 Without a restriction on transfers into the personal accounts scheme, there would be a risk of a substantial movement of funds from existing schemes into personal accounts at the point of introduction. This could affect the financial position of other pension providers, particularly as it would make it difficult for them to recover costs already incurred in establishing and marketing existing pension products.

3.77 A restriction on transfers into and out of the personal accounts scheme may also provide an important signal for employers and individuals that it is targeted at moderate to low earners currently without access to a good workplace pension scheme. This could be an important safeguard against the ‘levelling down’ of existing provision.

3.78 Individuals who leave a qualifying scheme before their rights vest will be able to transfer their cash transfer sum into the personal accounts scheme. This could provide a significant benefit to those affected. For example, someone earning £23,000 will accumulate a fund of £2,870 in the maximum pre-vesting period of two years. If they were unable to transfer this fund to their personal account they might instead take a cash value refund and they would then lose the benefits of the employer contribution and tax relief, a loss of £1,435 in this example.

## **Impact on Government**

### ***Personal Accounts Delivery Authority***

3.79 During its advisory phase the Authority is being funded through grant-in-aid. In later stages, as the Authority’s role is extended to include the delivery of the scheme, it is anticipated that the Authority’s running costs in connection with that work will be met out of scheme revenues from membership charges. Before revenues from membership charges are available and sufficient, the Authority and Government will need to consider how to cover these costs as part of the funding strategy.

### ***Set-up and operation of the scheme***

3.80 As explained in paragraph 3.26, in the long run, the personal accounts scheme is intended to be self-financing, with the costs of operating the scheme covered by member charges. However, in the short run, before the scheme goes live, there will be costs associated with the set up of the scheme which cannot initially be covered by members’ charges.

3.81 Many of the activities needed to set up and run the scheme will be outsourced to private contractors. The Authority is advising on the design of the scheme and

assessing the implications this will have for the cost of building the scheme. The costs will not be finalised until the Authority has undertaken negotiations with private contractors to deliver the scheme. This cannot take place until some time after the Bill has received Royal Assent. At this stage in the development of the personal accounts scheme the Government cannot publish its estimated cost due to commercial confidentiality and the potential risk that doing so could influence the commercial process. Services will be procured through competitive tendering, meaning private sector suppliers will be able to bid for contracts. The competitive tendering process will ensure that the Authority achieves good value for money.

## Implementation and delivery plan

3.82 Implementing these proposals and managing the relationships with around 1.2 million employers and between 4 and 7 million individuals will be a major challenge. That is why we have established the Authority to bring in expertise from the private sector to work with stakeholders to develop and deliver our proposals.

3.83 In developing how the personal accounts scheme will be implemented by 2012, we expect the Authority to:

- consider best practice and lessons learned in other large-scale projects, including National Audit Office and Office of Government Commerce guidance recommending that the implementation of major programmes is broken down into manageable steps;
- build on the existing consensus around pension reform and the personal accounts scheme by consulting with stakeholders to inform implementation proposals;
- understand the delivery capability and capacity of potential suppliers who will need to manage implementation risks;
- develop a supporting communications and marketing strategy to ensure awareness of the proposals and that specific information is delivered and understood; and
- take account of the principles the Government has set for guiding pension reform proposals.

3.84 The Authority will be setting up a series of meetings and consultations to engage with a full range of stakeholders. It has already established a consumer representative committee and has announced that it will set up an employers' panel. This will help to ensure that the design of the personal accounts scheme reflects the needs of our target group and, as implementation moves forward, will involve consumers and employers to test and refine ideas and operations and ensure that the consumer remains at the heart of the reforms.

## **Reporting procedures**

3.85 The Authority is a non-departmental public body and as such comes under the stewardship of DWP as the sponsoring department. The Authority is required to report annually to the Secretary of State who will lay the report before Parliament.

**Competition impact** – see Annex B

**Gender impact** – see Annex C

**Race impact** – see Annex D

**Disability impact** – see Annex E



# Chapter 4: Compliance

## Objectives

4.1 The Government's reforms to the private pension system will introduce important new rights for workers and requirements for employers. The main objectives of the compliance regime will be to ensure that:

- those rights are effectively safeguarded while imposing no unnecessary burdens on business;
- there is a level playing field for employers so that those who fail to comply with the requirements do not achieve a commercial advantage over those who do comply; and
- the need to take compliance action is kept to a minimum by developing an effective communications strategy so that employers know what they are required to do and when to do it.

## Rationale

4.2 The Government has developed policy proposals for managing the following three key risk areas of potential non-compliance:

### **Risk 1 – risk to automatic enrolment:**

- employers might fail to correctly register how they will automatically enrol their eligible workers; and
- employers might fail to provide access to a pension scheme that meets the qualifying criteria.

### **Risk 2 – risk to the opt-out process:**

- employers might interfere with the opt-out process by pressurising workers or prospective workers into opting out.

### **Risk 3 – risk to payments:**

- employers might fail to make payments due for members of qualifying schemes at the correct time.

## Consultation

- 4.3 The Government has involved a wide range of representative stakeholders and other government departments in the development of the compliance policy. This will continue as the detail on how the policy is to be implemented is developed.
- 4.4 Stakeholders have broadly agreed with the main principles of the proposed compliance regime outlined in the December 2006 White Paper: that it should provide effective protection for individuals' rights while being risk-based to avoid unnecessary burdens on compliant employers and take a proportionate approach with the non-compliant, in line with best practice in regulation.
- 4.5 There has also been agreement on the overarching approach recommended in the December 2006 Regulatory Impact Assessment. This proposed automated data-matching compliance processes rather than relying on individuals to take action themselves through the Employment Tribunal or to whistle-blow to a compliance body.

## Summary of proposals

- 4.6 The proposed compliance regime addresses each of the main risks identified. During policy development, a range of options was considered. These are described in the appendix to this chapter and the chosen approach is outlined below:

### **Risk 1 - risk to automatic enrolment**

- 4.7 The Government believes that a proactive approach will be the most effective. Employers will be required to register how they will meet their new duties for each of the Pay As You Earn (PAYE) schemes that they run. This data will drive targeted compliance action in cases where employers fail to register. Failures to register will be detected by comparing registration records with employer data provided by HM Revenue and Customs (HMRC).
- 4.8 The compliance body will use information from pension schemes, whistle-blowing, and data already collected by other parts of government such as HMRC, to trigger interventions focused on high-risk employers.
- 4.9 Careful consideration has been given to the need for registration and the automated processes that support it. The Government believes the cost is justified by the anticipated effectiveness of gaining a high level of employer engagement and compliance at an early stage.
- 4.10 It is very difficult to predict accurately how employers will respond to the new requirements and corresponding compliance activity at this point. Estimated compliance rates are therefore uncertain. We estimate that, without the

registration process, around 60 per cent of employers could be expected to comply with the new requirements<sup>119</sup>.

4.11 By introducing a registration requirement the compliance body will be able to identify and pursue non-compliant employers immediately. Our analysis suggests that in this way compliance levels could be much higher, with somewhere in the region of 90 per cent of employers registering the scheme into which they will automatically enrol their eligible workers. This is based on the best evidence available and discussions between the Department for Work and Pensions (DWP), HMRC and the Pensions Regulator (tPR), though it should be recognised that much of this is new territory for compliance work.

## **Risk 2 – risk to the opt-out process**

4.12 It is important that an individual's decision about whether to opt out of their employer's designated pension is free from interference. The Government proposes to introduce a package of new statutory employment rights to protect individuals against the risk that some employers may try to pressurise the opt-out decision.

4.13 The package consists of two strands: protection in employment and protection before employment starts.

4.14 Protection in employment will include:

- rights not to suffer unfair dismissal or detriment on grounds related to pension membership. These rights will apply from day one of employment and will be enforced by giving individuals the right to take a case to the Employment Tribunal; and
- a measure which prevents any agreement being enforceable if it concerns giving up rights to membership of a qualifying pension scheme in return for inducements, for example, one-off payments or alternative levels of salary or benefits.

4.15 The Government recognises the risk that some employers might be tempted to screen out job applicants who might want to become pension scheme members or to pressurise them into agreeing to opt out. It therefore proposes to introduce the following measures to provide protection before employment starts:

- a prohibition on advertising a vacancy, or giving out other information about the job, in a way that states or implies that the person appointed would be required to opt out of the employer's pension scheme;
- a prohibition on asking questions about pension choices before a job offer is made (at interview, on the application form, or in any other way); and

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<sup>119</sup> This assumption was developed in discussion with compliance experts from The Pensions Regulator, Department for Business, Enterprise and Regulatory Reform (BERR) and HM Revenue and Customs.

- a restriction on agreements that seek to limit the employer duty to provide a qualifying scheme. This would mean that any term of an agreement would be void if it sought:
  - to absolve the employer of the duty to provide a qualifying scheme; or
  - to oblige the worker to opt out of the scheme; or
  - to limit or qualify the employer duty in any way.

### Risk 3 – risk to pension payments

4.16 This is a risk already faced by existing workplace pensions and there is a regime in place for managing it. The Government proposes to build on that approach. After the reforms the situation changes from one where pensions are provided voluntarily by employers to one where they must be provided for all eligible workers who do not opt out. This will bring a large number of employers into contact with pension provision for the first time. Late or non-payments are therefore likely to be a significant risk. The compliance regime will mitigate this risk as set out below:

- as now, pension scheme trustees will be required to monitor payments received, and report failures to make payments to tPR if they suspect that members' benefits are seriously at risk. In particular, reports will be required when payments remain unpaid 90 days after the due date or earlier, for instance, in cases of suspected fraud; and
- tPR will have powers to follow up unpaid contributions, and use fixed and escalating penalties.

## Costs and benefits

### Impact on individuals

4.17 A high level of compliance will facilitate the achievement of the social benefits that have been outlined elsewhere. With low compliance, fewer workers will receive the benefits of their own saving or their employer's contribution when they reach retirement. There will also be less opportunity for qualifying schemes to achieve economies of scale and offer low charges to their members. Non-compliance could lead to higher costs for workers across all schemes.

4.18 The Government believes that in the absence of an effective compliance regime, initial rates of non-compliance by employers could be as high as 40 per cent<sup>120</sup>. This may prevent as many as 2.8 million<sup>121</sup> workers from having access to a workplace pension that meets the qualifying criteria. The compliance regime

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<sup>120</sup> This is the converse of the 60 per cent compliance rate discussed in paragraph 4.10.

<sup>121</sup> DWP modelling.

is designed to ensure that as few of these workers as possible miss out on their rights.

### Impact on business

- 4.19 The compliance regime has been developed in line with the Hampton principles<sup>122</sup> to ensure that it minimises the impact on business and concentrates resources on the areas of greatest risk.
- 4.20 The proposed regime will place three potential costs on business. The first will be the administrative burden of registering with the compliance body and setting out how they will meet their new duties. Every employer will need to do this once for each PAYE scheme that they operate. They will only have to notify the body again in the case of a decision to use a different pension scheme or on the creation of a new PAYE scheme. The cost to employers from registration has been included in the overall administrative burdens presented in chapter 2 - it makes up around £9 million or 3 per cent of the total cost in year one and around £0.3 million or 0.3 per cent thereafter.
- 4.21 The work to design the final details of the registration process will focus on keeping the burden of registration as low as possible, while making sure that it still delivers the information needed for an effective compliance regime. This process is likely to include making best use of the Business Link<sup>123</sup> portal and integrating communication about registration with other contact between Government and new employers.
- 4.22 The second cost will only fall on employers who have further dealings with the compliance body. In most cases only non-compliant employers will be contacted. However, a small number of compliant employers may be contacted by the compliance body, for example if they are selected for investigation on the basis of a risk profile determined by employer characteristics.
- 4.23 The possible burden on compliant employers can be estimated by assuming that a small fraction of each of the compliance regime's interactions with employers takes place in error, and making assumptions about the cost to employers of actions such as reading an enforcement notice.
- 4.24 The total estimated burden on compliant employers is shown in Table 4.1 below:

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<sup>122</sup> The Hampton review sets out principles of inspection and enforcement, including: regulators should use comprehensive risk assessment; regulators should be of the right size and scope, and no new regulator should be created where an existing one can do the work; no inspection should take place without a reason; and businesses should not have to give unnecessary information. See Philip Hampton, *Reducing administrative burdens: effective inspection and enforcement*, March 2005.

<sup>123</sup> [www.businesslink.gov.uk](http://www.businesslink.gov.uk): A self-help portal of information for small and medium businesses, linked to all relevant ministries and departments.

<b>Table 4.1: Employer costs arising from the compliance regime</b>		
	Year 1 costs (£ million)	Ongoing costs in future years (£ million)
Completing the registration process	9	0.3
Further contact with the compliance regime	2	1
<b>Total</b>	<b>Around 12</b>	<b>Around 1</b>

Source: DWP modelling.

Notes: The cost of registration is included in the overall administrative burdens on employers that were presented in chapter 2. The costs of further contact will depend on the final details of the regime - the estimate costs presented here are therefore uncertain and illustrative only and are not included in chapter 2.

4.25 Effective compliance will help provide a level playing field for employers, with non-compliant employers being prevented from gaining an unfair commercial advantage over the compliant majority.

4.26 The third potential cost arising from the compliance regime could be from reporting requirements placed upon pension providers. Many schemes already complete an annual return to tPR and these requirements will build on those which are already in place but may involve collecting some additional information. This could mean that some extra costs fall on pension providers.

## Delivering the compliance regime

4.27 TPR will have responsibility for the compliance regime. In delivering the regime, it will be supported by DWP and there will be secure gateways to receive relevant employer data from HMRC. Other bodies were considered for the task of delivering the compliance regime and this is discussed below.

### Options

4.28 The possible options considered were:

- Option 1: the Department for Work and Pensions;
- Option 2: the personal accounts trustee body;
- Option 3: the Personal Accounts Delivery Authority;
- Option 4: The Personal Accounts Delivery Authority having sole responsibility for developing the compliance regime and handing over the responsibility to another organisation after 2012;
- Option 5: HM Revenue and Customs;

- Option 6: the Pensions Regulator; and
- Option 7: a mix and match approach, with responsibilities for both HMRC and tPR.

4.29 Only organisations with current roles in the pensions landscape or employer compliance were considered. The options were assessed according to their strengths in the following areas:

- legal and financial implications;
- organisational capacity and expertise to take on the role;
- fit with the Hampton Principles<sup>124</sup>;
- burden for employers, pension schemes and their members; and
- current involvement in pensions, regulation and employer compliance.

4.30 This assessment was carried out by the DWP, working with tPR, HMRC and the Department for Business, Enterprise and Regulatory Reform (BERR). The boxes below set out each option in turn.

#### **Option 1: DWP**

##### Benefits:

- good end-to-end accountability; one department and set of Ministers with overview of policy and delivery;
- experience in delivering large-scale administrative functions;
- existing links with employers; and
- experience in delivering compliance functions, for example in relation to the benefits system.

##### Drawbacks:

- no significant or relevant role around employer compliance or pension schemes;
- Hampton principles imply compliance strategy should be delivered by an organisation with relevant experience and interactions with those affected; and
- compliance with Hampton principles is a priority for the Government.

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<sup>124</sup> The Hampton review sets out principles of inspection and enforcement, including: regulators should use comprehensive risk assessment; regulators should be of the right size and scope, and no new regulator should be created where an existing one can do the work; no inspection should take place without a reason; and businesses should not have to give unnecessary information. See Philip Hampton, *Reducing administrative burdens: effective inspection and enforcement*, March 2005.

**Option 2: Personal accounts trustee body**

## Benefits:

- links with the majority of employers required to comply with the new obligations.

## Drawbacks:

- conflicts with the requirements on scheme trustees to act only in members' best interests and not to use trust assets for any other purpose;
- can only carry out activity relating to provision of retirement benefits; and
- does not have the power to impose penalties on employers.

**Option 3: Personal Accounts Delivery Authority**

## Benefits:

- new organisation could minimise risk that other bodies' existing activities are negatively affected by the new work.

## Drawbacks:

- continuing the Authority post-2012 would create a new regulatory organisation;
- at odds with the Hampton principles, with potentially higher costs and employer burdens; and
- new organisation could mean higher burdens for some employers who might have to work with both tPR and the new organisation to resolve certain pension issues.

**Option 4: Personal Accounts Delivery Authority handing over to another organisation post-2012**

## Benefits:

- flexibility to consider changes to the pensions and regulatory landscape between now and the handover date;
- makes use of the Authority's expertise developed during design of the personal accounts scheme; and
- compliance functions could eventually transfer to the most appropriate body, avoiding creation of a new, permanent compliance body.

## Drawbacks

- postponing decision about delivery until after 2012 would prevent the ultimate delivery organisation from having the maximum possible involvement in the design of the regime; and
- will create uncertainty for employers, trustees and the pensions industry.



**Option 5: HMRC**

## Benefits:

- experienced in employer compliance;
- existing relationships with employers;
- experienced in large-scale activity; and
- owns the PAYE data needed for the employer registration process.

## Drawbacks:

- already committed to a substantial change programme as well as seeking to maintain delivery of its wide-ranging responsibilities;
- responsible for collection of more than 75 per cent of total Government receipts, which were £485 billion last year<sup>125</sup>. It would be difficult to take on an additional function and manage further change without risk both to delivery of the new function and to its existing commitments;
- would probably have to create compliance teams and IT systems to support this work, making economies of scale in costs and employer burdens unlikely;
- split ministerial accountability for policy and delivery; and
- could mean removal of responsibility for late employer contributions from tPR and have an impact on tPR's wider regulatory responsibilities.

**Option 6: tPR**

## Benefits:

- good fit with pensions landscape; pensions compliance would be delivered by the Pensions Regulator;
- good end-to-end accountability; DWP ministers would be responsible for both policy and delivery aspects of compliance;
- because tPR is a relatively small organisation at present, the new role could have a higher profile and priority within the regulator than might be the case in, for example, HMRC; and
- successful delivery organisation.

## Drawbacks:

- tPR lacks experience and infrastructure in large-scale activities;
- while tPR has some experience of employer compliance in relation to late payments, the new work will be on a much larger scale; and
- tPR would have to create compliance teams and IT systems from scratch in addition to improving links with employers.

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<sup>125</sup> 2007 Pre-Budget Report and Comprehensive Spending Review.

**Option 7: Mix and match of HMRC and tPR**

## Benefits:

- potential for efficiency by building on each organisation's current activities; and
- could reduce delivery risk relative to one of the organisations taking on all the compliance activity.

## Drawbacks:

- would add significant complexity to accountability and governance arrangements; and
- could require significant duplication of IT systems and more hand-offs across systems, increasing the cost and perhaps employer burdens.

**Decision that tPR should run the compliance regime**

4.31 As described above, there are legal reasons that mean the personal accounts trustee body would not be suitable to run the compliance regime. Ongoing management of the compliance regime by either the Personal Accounts Delivery Authority or DWP was rejected on the grounds that this would make the regulation of pensions more complex by involving an extra organisation, but without significant benefits.

4.32 The final decision was between HMRC, tPR, or a combination of both.

4.33 Although a mixed approach could allow for the two organisations to specialise in those elements of the regime most relevant to their current work, this option was rejected on the grounds that it would be likely to increase costs.

4.34 It was recognised that if HMRC were to run the regime, some costs might be marginally lower than under other options. DWP has discussed the potential savings with tPR, HMRC and the BERR. However, we have been unable to identify areas in which the costs or employer burden would differ significantly across the delivery options. It is very unlikely that this compliance work could be included with tax-related compliance activity; instead new systems and teams would be needed. This suggests that, against the background of the overall costs involved, the costs are likely to be very similar whether tPR or HMRC were to take on the role.

4.35 In other areas, which are not directly related to costs, tPR has some key advantages:

- successful pensions organisation, most recently recognised in a National Audit Office report<sup>126</sup>;

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<sup>126</sup> National Audit Office, October 2007, *The Pensions Regulator: Progress in establishing its new regulatory approach*.

- the stewardship of the DWP; and
- potential to increase its capacity, make enforcement of the new employer requirements a priority and ensure effective delivery of the Government's reforms.

4.36 The decision has been made that tPR should be the compliance body. As well as extending tPR's objectives and powers so that it can take on this role, the Bill will take powers to allow the Personal Accounts Delivery Authority to work with tPR as it develops the compliance regime. This new work will be a major change for tPR and will present challenges. But tPR is a high-performing organisation and it should be able to adapt and grow to deliver a successful compliance regime.

## Appendix 1: Options considered for the compliance regime

1. This appendix gives more detail about the decisions that were made during the design of the compliance regime outlined in the main text.
2. As described in the main document, there are three main areas of compliance risk. These are:
  - automatic enrolment;
  - interference with the opt-out process; and
  - late payment of contributions.
3. The preferred approach was chosen by considering the effect on Government, individuals, employers and the pensions industry, as well as the legal implications.

### **Risk 1 - Automatic enrolment**

4. Employers may fail to meet the new requirement to provide access to a pension scheme that meets the qualification criteria. Experience suggests that once employers engage with the new pensions regime by setting up the correct pension joining process for their workers, they will not generally set out to avoid their responsibilities at a later point in the process. For this reason, it is particularly important that risk 1 is proactively managed.
5. The chosen approach therefore includes a requirement for employers to register how they will meet their new responsibilities and automated follow-up of those that fail to do so. It will be supported by a whistle-blowing hotline, investigations, and proportionate penalties where they are appropriate.
6. Below are the three options that were considered for dealing with the risk to automatic enrolment:
  - option 1: employee enforcement through an Employment Tribunal;
  - option 2: use the National Minimum Wage (NMW) compliance regime as a model; and
  - option 3: use registration and automated administrative processes to support compliance.
7. Options 1 and 2 are largely reactive, and do not include a registration process. They rely on workers taking action when their employer fails to meet the new duties. The chosen approach, option 3, is more proactive.

**Option 1: There is no registration process and enforcement is left to the worker. The information strategy would be designed to maximise initial compliance but where employers do not meet their responsibilities, workers would have the right to take a case to Employment Tribunal.**

Benefits:

- inexpensive for Government – costs include responding to queries and the burden on the Employment Tribunal Service; and
- very few employers would be affected.

Drawbacks:

- workers are unlikely to take action because: it is costly - around £5,000 per individual on average<sup>127</sup>; it provides no immediate benefit – the value of the employer contribution would only affect the individual after retirement; and there is considerable individual inertia in pension saving;
- high burden on some employers from vexatious claims – total cost around £8 million per year<sup>128</sup>;
- could mean very low compliance - perhaps 3,000-4,000 extra employers affecting 20,000 eligible workers<sup>129</sup>, compared to a baseline of 60 per cent employer compliance<sup>130</sup>;
- almost 2.8 million eligible workers could miss out on correct pension access<sup>131</sup>; and
- open to legal challenge on the grounds of ineffective enforcement.

**Option 2: There is no registration process and compliance is still largely driven by the worker. Where an employer doesn't meet the requirements, workers can contact the compliance body which can investigate on their behalf. The compliance body can also conduct some risk-based investigation into possible non-compliance.**

Benefits:

- builds upon a familiar approach used for the National Minimum Wage;
- fewer employers would face the expense of an Employment Tribunal than under option 1, because the compliance body would resolve most cases before they reach that stage. Total employer burden in the region of £1 million; and
- some flexibility to undertake limited proactive, risk-based activity to gain extra compliance.

Drawbacks:

- extra costs to Government, compared with option 1, from: running whistle-blowing hotline, investigating and resolving non-compliance, imposing penalties where necessary and a small amount of civil or criminal court action;

<sup>127</sup> Survey of Employment Tribunal Applications 2003.

<sup>128</sup> DWP modelling.

<sup>129</sup> DWP modelling.

<sup>130</sup> This estimate was developed in discussion with compliance experts from tPR, HMRC and BERR.

<sup>131</sup> DWP modelling.

- workers are unlikely to whistle-blow for reasons similar to those discouraging action under option 1;
- could mean very low compliance<sup>132</sup>. Perhaps 3,000-6,000 thousand extra employers, affecting up to 30,000 eligible workers could comply as a direct result of this regime, compared to a baseline of 60 per cent employer compliance; and
- expanding risk-based investigation to improve compliance would increase burdens on compliant employers. This kind of investigation is expensive to carry out and would be a costly way to gain extra compliance.

**Option 3: Employers will be required to register how they will meet their responsibilities and employers who fail to do so will be pursued by the compliance body. Investigation of other types of non-compliance will focus on high-risk employers highlighted by intelligence from other government departments, whistle-blowing, or other sources. These interventions will ensure that employers fully comply after the registration process.**

**Benefits:**

- registration process allows the compliance body to clearly identify employers who have not engaged with their duties, and focus on those cases, minimising burdens placed upon the compliant majority;
- this early intervention is expected to produce high compliance with registration and automatic enrolment. Perhaps 350,000 extra compliant employers could affect pension access for around two million workers<sup>133</sup>, in comparison with a baseline of 60 per cent employer compliance; and
- less reliant on worker action, though still an opportunity to whistle-blow.

**Drawbacks:**

- extra costs and some delivery risk from the web-based registration process and follow-up; and
- administrative burden placed on every employer by requirement to register<sup>134</sup>. Total burden would be around £1.2 million per year in steady state<sup>135</sup>.

### Choice of option 3

8. Under options 1 and 2, around 2.8 million eligible workers could fail to be enrolled into a pension scheme. Such low level of compliance could seriously undermine the policy intent of increasing saving and retirement income amongst the target group.
9. Table 4.2 below summarises the costs of the three options discussed.

<sup>132</sup> This estimate was developed in discussion with compliance experts from tPR, HMRC and BERR.

<sup>133</sup> DWP modelling.

<sup>134</sup> Every employer will need to do this once for each PAYE scheme that they operate, and will only have to notify the body again in the case of a decision to use a different pension scheme, or on the creation of a new PAYE scheme.

<sup>135</sup> DWP modelling.

**Table 4.2: Summary of options for dealing with the risks to automatic enrolment**

Summary of options for dealing with the risks to automatic enrolment	Potential burden on compliant employers (£ million)	Extra workers benefiting relative to 60% employer compliance (thousands)
1: Through Employment Tribunal	8	20
2: National Minimum Wage (NMW) as model	0.7	30
3: Automated administrative processes	1	350

Source: DWP modelling.

10. Option 3 has been chosen on the grounds that it strikes the correct balance between costs imposed on business and benefits from higher compliance. There will be an employer registration process which will inform automated compliance activity, as well as whistle-blowing and risk-based investigation.

## **Risk 2 - Interference with the opt-out process**

11. Employers might interfere with the opt-out process by, for example, requiring prospective workers to agree to opt out before offering them a job or, once employed, putting pressure on them to do so, through inducements such as one-off payments, or through threats, such as withholding pay increases for those workers who do not opt out.

12. The decision whether or not to opt out of pension scheme membership should be freely taken by the individual. The Government does not anticipate that many employers will seek to pressurise their workers to opt out, but the risk that a significant minority might be tempted to do so means that doing nothing is not a viable option.

13. Non-compliance of this kind is more likely to be detected and successfully pursued where an individual actively complains about the situation. The Government therefore sees value in the creation of new employment rights enforceable via the Employment Tribunal system to help manage this risk.

### **Option 1: Introduce new rights not to be unfairly dismissed or suffer detriment on grounds related to pension scheme membership.**

14. Individuals would, from day one of employment, receive protection from the most blatant forms of pressure to opt out of pension scheme membership. That is, protection from being dismissed or being subject to various forms of detrimental treatment such as being unfairly treated in terms of pay, training opportunities or selection for redundancy.

**Option 2: Introduce new dismissal and detriment rights and a restriction on agreements to limit or exclude the employer duty which will offer protection against employers offering inducements.**

15. Under this option, in addition to the protection offered under option 1 against the most negative forms of coercion, individuals would also receive protection against employers trying to encourage them to opt out by offering them positive inducements. This should deter employers from offering one-off payments or alternative salary levels or benefits in return for individuals giving up their right to a qualifying pension.

**Option 3: Introduce new rights as above plus a pre-employment right not to be refused employment on grounds relating to pension scheme membership.**

16. This option recognises that pressure on the opt-out decision could be applied before employment starts. It therefore proposes that individuals be given a right not to be refused a job because they want to become, or want to remain, a member of a pension scheme. The route to redress would be for individuals to take a case to the Employment Tribunal if they feel they had been unlawfully refused employment.

**Option 4: Introduce new rights as above (under option 1) plus a prohibition on screening out those who want to become pension scheme members during the recruitment process.**

17. This option also recognises that pressure on the opt-out decision could be applied before employment starts. But instead of giving individuals a right not to be refused employment on certain grounds it proposes that employers be prohibited from asking specific questions about pension scheme membership before offering a job, for example in job advertisements, interviews, job applications and job offers.

**Choice of option 4**

18. The Government has concluded that option 4 will offer workers the most appropriate level of protection, both before a job is offered and once employment has started. The protection offered to individuals before employment starts should be as effective in practice as that offered under option 3, but without employers fearing the cost of vexatious claims for compensation by unsuccessful job applicants.

19. It is not anticipated that large numbers of cases will be brought to the Employment Tribunal. But the Government considers that this package of new rights will present a powerful message and act as an effective deterrent.

**Risk 3 – Late payment of contributions**

20. Employers might fail to make payments due for members of qualifying schemes at the correct time.



***Current regime for late payments into work-based pensions***

21. The trustees of occupational pension schemes are currently required to draw up and agree the contributions employers will make to scheme members, to monitor the payments received and pursue any payments the employer misses.
22. Trustees are required to report failures to make payments to tPR if they suspect that members' benefits are seriously at risk. This is not generally required until payments remain unpaid 90 days after the due date.
23. TPR takes a risk-based approach to late payments and takes action when members' benefits are viewed to be at serious risk. TPR has powers to fine employers for late payments, but prefers to assist trustees in getting any monies available into the pension fund. As tPR intervenes in only a small number of cases it is able to take an individual approach with employers. Overall the current regime appears to work well for existing schemes.
24. The reforms introduced through this Bill transform the pensions landscape, moving from a situation where pensions are provided voluntarily by employers to one where they must be provided for all eligible workers who do not opt out. Many employers will be new to pension provision and late payments are therefore expected to be a significant risk.
25. The following criteria were used when judging the options for managing this area of compliance risk:
  - protection given to members' contributions;
  - costs for schemes and the compliance body;
  - impact on confidence in personal accounts and other qualifying schemes;
  - Article 6(1) of the European Court of Human Rights considerations, and the need for new requirements to be adequately enforced;
  - effectiveness for all qualifying schemes; and
  - any adverse impact on existing schemes.

**Option 1: pursue all unpaid contributions.**

26. Whilst this approach would give greatest protection to members it was rejected as it would be impractical to administer and costly. It would mean pursuing small amounts of debt even where it was not cost-effective to do so. This would conflict with the overriding duty of trustees to act in the interests of their members as a whole. Equally, it would not be cost-effective for the compliance body to devote resources to pursuing small debts never likely to be recovered.

**Option 2: pursue all unpaid contributions where it is cost-effective to do so.**

27. This option would see the compliance body given powers to make debts more cost-effective to pursue. This could be done by, for example using escalating penalties or amalgamating debt (taking action once several debts and penalties have accumulated).

**Choice of option 2**

28. The Government has concluded that option 2 would be the most effective in delivering the policy's aims. The details of how this approach will be implemented will be developed and agreed with the Pensions Regulator.

# Chapter 5: Strengthening existing provision

## Proposals arising from the Deregulatory Review

### Objectives

- 5.1 The aim of these measures is to reduce the regulatory burdens on employers in order to encourage them to continue to provide good pension schemes for their employees, while balancing the need to protect members' interests.

### Rationale

- 5.2 The present regulatory system governing occupational pensions has grown incrementally over the course of the past 30 years. It is now, by common consent, lengthy, complicated and hard to understand. Although each successive layer usually had the aim of protecting scheme members or simplifying the regulatory structure, there have been unintended consequences, leading to undesirable outcomes. Whilst by no means wholly attributable to the growth of regulatory burdens, there is little doubt that the weight of regulation has contributed to a belief by some employers that the costs and risks of having their own pension schemes are becoming too great.
- 5.3 The number of active members of private sector defined benefit pension schemes has been falling steadily since the late 1960s, down from a peak of 8.1 million members in 1967 to 3.4 million in 2006<sup>136</sup>.
- 5.4 In May 2006, the Government announced a rolling deregulatory review of the rules governing private pensions. As part of this it appointed Chris Lewin and Ed Sweeney in December 2006 to act as external reviewers and to make recommendations for change. Their report, *Deregulatory Review of Private Pensions*, was published on 25 July 2007.
- 5.5 The Government is committed to reducing legislative burdens on employers but recognises that there needs to be a balance between reducing legislative complexity and protecting members' interests.
- 5.6 The Government also recognises that it is important that there should be scope, where appropriate, for scheme rules to be amended to reflect any legislative easements.

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<sup>136</sup> Office for National Statistics, *Occupational Pension Schemes Survey*, 2006.

## Summary of proposals

5.7 The following measures will be brought forward in this Bill. The majority were first outlined in the Government Response to the reviewers' report published on 22 October 2007.

### ***Reduction in the cap applying to revaluation of deferred pensions***

5.8 The revaluation legislation currently requires schemes to protect the value of early leavers' deferred pensions against inflation and does this by increasing the amount of pension payable from normal pension age by the increase in the retail price index (RPI) over the period of deferment, or by 5 per cent compound, whichever is less. Providing revaluation for deferred pensions imposes costs on employers, and provides benefits for former members of schemes in the form of an element of protection of the value of the deferred pension.

5.9 The Government will reduce the cap applying to revaluation of deferred pensions from 5 per cent to 2.5 per cent for future accrued rights. This is expected to take effect from January 2009 and will only apply to rights accrued after that date.

### ***Safeguarded rights***

5.10 When a divorcing couple, or civil partners dissolving their partnership, seek a financial settlement, the court must take into account the value of any pensions held by either party to the divorce. In order to achieve a fair financial settlement one of the options open to the court is to make a pension sharing order requiring a proportion of the value of the pension scheme member's shareable pension rights to be transferred to the former spouse or civil partner. The former spouse's or civil partner's share is then discharged into a pension arrangement as a pension credit (i.e. rights which arise from pension sharing, not a State Pension credit).

5.11 When the member of a scheme is divorced, or becomes a former civil partner, and their pension credit includes contracting out rights, the former spouse's or civil partner's share of those rights is known as "safeguarded rights". These rights are subject to a detailed regulatory regime restricting the type of scheme that can hold these rights and the way in which those rights can be paid. There have been complaints that the special requirements which apply to safeguarded rights introduce unnecessary complexity.

5.12 The Government will therefore repeal the requirements relating to safeguarded rights, thereby removing an unnecessary layer of extra complexity for scheme administrators.

### ***Removal of the employer stakeholder designation requirement***

5.13 From 2012, all employers will be required to automatically enrol eligible workers into a qualifying workplace pension scheme. This will make obsolete the

current requirement that employers with five or more employees must (unless they provide appropriate alternative pension arrangements) designate a stakeholder pension scheme. The Government therefore proposes to remove this requirement, although employers may still continue to offer stakeholder pensions as qualifying schemes or as an additional pension saving option.

5.14 Removing this requirement is consistent with the Government's aim to simplify the pensions system for employers. It will mean that employers no longer have a statutory duty to:

- designate a stakeholder pension scheme;
- consult their workforce about their choice of scheme;
- supply employees with information about the scheme;
- supply information to the pension provider; and
- permit representatives of the pension provider access to the workforce.

5.15 Where, at the point when the personal accounts scheme is introduced, employees are contributing into their stakeholder pension scheme by payroll deduction, employers will continue to deduct and pay contributions to the pension provider. This transitional provision will apply until the individuals concerned stop paying contributions into their stakeholder pension or leave the employers' employment. Employers who make payroll deductions for employees covered by this transitional provision will continue to benefit from a residual provision which limits their duty to make enquiries about the scheme.

## Costs and benefits

### Impact on schemes/employers

#### ***Reduction in the cap applying to revaluation of deferred pensions***

5.16 A reduction in the cap would deliver potential savings for employers. These are estimated to be up to £250 million (2007/08 prices) a year on average, although in the long-term they could rise to as much as £400 million (2007/08 prices) a year<sup>137</sup>. This assumes that all affected employers take advantage of the reduction in the cap (and that a statutory override is provided to help overcome inflexible scheme rules where they exist). The key assumption in this is a long-term inflation rate of 2.9 per cent, in line with HM Treasury forecasts<sup>138</sup>. As most defined benefit pension schemes are provided by medium and large enterprises the proposal is more likely to be of benefit to organisations of those sizes.

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<sup>137</sup> Source: DWP modelling.

<sup>138</sup> This is consistent with the Bank of England meeting its inflation target of 2 per cent of the Consumer Prices Index (CPI) on average. Annex H explains our assumptions in more detail.

5.17 Overall, we estimate that reducing the cap would result in total savings to employers of up to £4.4 billion (in present value terms) over the period to 2050<sup>139</sup>.

### ***Safeguarded rights***

5.18 There are around 10,000 pension sharing orders per annum, of which it is estimated 4,000-5,000 will be affected by this change. Savings to employers are therefore likely to be small given the numbers involved. However, there will be benefits for scheme administrators who have members with safeguarded rights in that they won't have an extra layer of complexity when dealing with pension credit rights.

### ***Removal of stakeholder designation requirement***

5.19 The Department for Work and Pensions (DWP) estimates indicate a saving to employers of around £12 million a year from the removal of the stakeholder designation requirement. This saving arises in two parts. First, new employers with five or more employees will no longer incur the costs of designating a stakeholder pension scheme and setting up payroll collection facilities for their employees. Second, as people move jobs there will be fewer and fewer employees actively saving in existing stakeholder schemes through their employer, further reducing employer administrative costs.

### **Impact on individuals**

5.20 The deregulatory measures contained in the Bill are aimed at supporting the continuation of defined benefit pension provision by generating savings for employers with defined benefit schemes. This could be beneficial to individuals if employers redirect these savings back into pension provision.

### ***Reduction in the cap applying to revaluation of deferred pensions***

5.21 The impact of a reduction in the revaluation cap for deferred pensions for future pension accruals will depend on the level of pension built up after the requirement is removed, the length of time which elapses before the pension comes into payment and the rate of inflation over that period.

5.22 Our analysis indicates that a reduction in the cap on revaluation would have very little effect on average private sector incomes from defined benefit schemes. The table below shows the percentage reductions in average private sector defined benefit pension income compared to the status quo, assuming a long-term inflation rate of 2.9 per cent and a reduction in the cap from 2009<sup>140</sup>. We assume that all schemes will take advantage of the reduced cap.

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<sup>139</sup> Source: DWP modelling.

<sup>140</sup> This is consistent with the Bank of England meeting its inflation target of 2 per cent of the Consumer Prices Index (CPI) on average. Annex H explains our assumptions in more detail.

**Table 5.1: Percentage reductions in average private sector defined benefit pension income compared to the base case, assuming a long term inflation rate of 2.9 per cent and a reduction in the cap from 2009**

2.5% cap - 100% deferred pension affected by the change	
2020	0.2%
2030	0.5%
2040	1.1%
2050	1.6%

Source: DWP modelling

- 5.23 Deferred pensioners are likely to have a number of different sources of pension income, reducing the impact of any fall in the value of any single deferred pension on their total pension income. There may be a particular impact on women, which is discussed below.
- 5.24 In addition to these direct impacts, there is the possibility that employers will be able to keep their defined benefit schemes open for the benefit of future employees. It is very difficult to estimate the size of this benefit but one approach would be to consider the scenario whereby the employer chooses to channel these savings back into pension provision. Assuming all the savings from the change were spent by employers on expanding the coverage of their defined benefit schemes, we estimate up to 165,000-265,000 additional defined benefit members per year in the medium to long-term. In practice the actual impact would almost certainly be lower than this since employers are unlikely to choose to spend all the savings on expanding the coverage of their defined benefit schemes. The impact of these proposals is dependent upon employer behaviour and therefore uncertain.
- 5.25 In addition there is likely to be a redistribution of pension income from the best-off defined benefit scheme members (under current revaluation rules) to the group who are able to join defined benefit schemes following the change but who would otherwise have been outside the scheme. This would be expected to raise overall social welfare.

### ***Safeguarded rights***

- 5.26 The benefits to individuals of repealing the requirements relating to safeguarded rights will arise through increased flexibility in transferring their pension credit rights, since the individual's choice of scheme will no longer be restricted to a scheme that will accept contracted out rights. It will also remove the restrictions on how safeguarded rights can be paid, giving the individual the same choice and flexibility to take their benefits as other pension credit members. For example, safeguarded rights held in a personal pension scheme cannot be paid until age 60. Abolishing safeguarded rights would allow these rights to be paid from age 50 (age 55 from 2010) if the individual so wished.

***Removal of stakeholder designation requirement***

5.27 Individuals who are active members of a stakeholder pension when personal accounts are introduced will benefit from a provision that will enable them to continue paying into their stakeholder pension via their employer if they wish to do so. In 2012, all eligible workers will benefit from automatic enrolment into a qualifying workplace pension scheme and receive a minimum employer contribution. The minimum employer contribution will apply to stakeholder pensions which meet the qualifying criteria.

**Small firms impact test**

5.28 These proposals would impact on employers who operate defined benefit pension schemes and on some employers who operate defined contribution pension schemes. Smaller companies are less likely to provide defined benefit occupational pension schemes for their employees than medium to larger enterprises. The proposal for reduction in the revaluation cap from 5 per cent to 2.5 per cent has the same impact on the costs of providing members' benefits regardless of the size of the employer.

5.29 The removal of the requirements relating to safeguarded rights will produce some small administrative savings as it removes a layer of administrative complexity. This may be of more benefit to smaller firms who have smaller occupational schemes as the extra administrative burden imposed by safeguarded rights may be proportionally greater in a smaller pension scheme.

5.30 Removing the stakeholder designation requirement will benefit all employers with five or more employees who do not have an appropriate alternative pension arrangement in place. As such, this measure is likely to have more of an impact on smaller employers, who are less likely than larger employers to have established occupational schemes in the past. This helps to offset the cost to small firms of complying with new requirements to automatically enrol eligible workers into a qualifying workplace pension scheme and contribute a minimum towards it.

**Impact on Government*****Income-related benefits***

5.31 Individuals whose income falls below a certain level may be entitled to income-related state benefits. In theory, the reduction in the income of scheme members arising from a reduction in the revaluation cap may push some of those members on to income-related state benefits. However, the size of the impact on average incomes shown above makes this seem unlikely in practice. Indeed our analysis shows that the additional impact on entitlement to income-related state benefits is negligible.

**Competition impact**



5.32 These proposals would affect any company which has a salary related pension scheme and, in the case of safeguarded rights, a company who operates a contracted-out money purchase pension scheme. They are not expected to affect any particular market sector.

5.33 The Government's proposal to reduce the revaluation cap from 5 per cent to 2.5 per cent and removal of the requirements applying to safeguarded rights will entail some minor one-off costs to administration systems, but these costs should have no impact on competitiveness.

### **Gender impact**

5.34 The proposal for a change to the cap on revaluation is designed to encourage continued provision of defined benefit schemes and that will be of equal benefit to men and women in these schemes as well as any potential new members.

5.35 Defined benefit pension schemes have traditionally been established in male dominated industries at a time when female participation in the labour force was far lower than it is today. Consequently any change to the regulatory framework for defined benefit schemes is likely to impact more on men than women.

5.36 The proposed change to the revaluation cap may however have a particular impact on female scheme members because some women earn pension benefits early in their careers and then leave the work force for periods of time to undertake caring responsibilities. However, as already outlined in paragraph 5.22 the impact on any individual member is, on average, likely to be small.

5.37 The change to the revaluation cap should be seen as part of the wider pension reform package which has already seen improvements to the state pensions system by recognising the social and economic contribution made by women and carers. The private pension reforms, outlined elsewhere in this Impact Assessment, will, for the first time, provide genuine equality of opportunity in the access to private pension provision, enabling more women to take responsibility for their own income in retirement.

5.38 Removal of the requirements applying to safeguarded rights would have minimal impact on individuals but it will provide them with more scope should they wish to transfer their pension credit rights. Anecdotal evidence is that more pension sharing orders on divorce are made in respect of women than men so the minimal benefits for individuals are likely to impact more on women than men.

### **Race and disability impact**

5.39 These proposals are not expected to have any consequences for race equality or disability equality.

### **Implementation and delivery plan**

5.40 It is intended to commence the reduced revaluation cap from 1 January 2009.

5.41 Safeguarded rights will be abolished by commencement order after the Bill receives Royal Assent.

5.42 The removal of the stakeholder designation requirement is intended to coincide with the introduction of personal accounts from 2012.

# Appendix 1: Summary of measures arising from the Deregulatory Review

Summary: Intervention & Options		
Department /Agency: Department for Work and Pensions	Title: Impact Assessment of Pensions Bill: Measures arising from the Deregulatory Review of Private Pensions	
Stage: Introduction of Bill	Version: 1.0	Date: 5 December 2007
<b>Related Publications:</b> Deregulatory Review of Private Pensions, A Consultation Document Deregulatory Review of Private Pensions, an independent report by Chris Lewin and Ed Sweeney. Deregulatory Review-Government Response		
Available to view or download at: <a href="http://www.dwp.gov.uk/pensionsreform/deregulatory_review.asp">http://www.dwp.gov.uk/pensionsreform/deregulatory_review.asp</a>		
Contact for enquiries: Ruth Saunders		Telephone: 020 7712 2059
<p>What is the problem under consideration? Why is government intervention necessary?</p> <p>The extent of the burden on employers of private pensions legislation and the effect on their willingness to provide pension schemes for their employees. Government has stated that it wants to make legislation simpler and less burdensome. The Government is undertaking a rolling deregulatory review of private pensions legislation.</p>		
<p>What are the policy objectives and the intended effects?</p> <p>The aim is to reduce the regulatory burdens on employers to encourage them to continue to provide pension schemes for their employees. The reduction in legislative burden on employers needs to be balanced against the impact on protection for members.</p>		
<p>What policy options have been considered? Please justify any preferred option.</p> <ul style="list-style-type: none"> <li>• Revaluation of deferred pensions-reduce cap from 5% to 2.5%</li> <li>• Repeal pension sharing safeguarded rights requirements</li> </ul>		
<p>When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? 2013</p>		
<p><b>Ministerial Sign-off</b> For final proposal/implementation stage Impact Assessments:  <i>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.</i></p> <p>Signed by the responsible Minister:</p> <p>..... Date: 5 December 2007</p>		

Summary: Analysis & Evidence					
Policy Option: Reduce revaluation cap to 2.5%		Description: Reduce revaluation cap			
COSTS	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups'		
	<b>One-off</b> (Transition)	<b>Yrs</b>	Savings for employers are generated from a corresponding reduction in the level of inflation protection provided for members' benefits. Public sector - estimates indicate that costs of increased payments of income related state benefits are negligible.		
	£ 0				
	<b>Average Annual Cost</b> (excluding one-off)				
	£ 250 million		<b>Total Cost (PV)</b>	<b>£ 4.4 billion</b>	
Other <b>key non-monetised costs</b> by 'main affected groups'					
BENEFITS	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups'		
	<b>One-off</b>	<b>Yrs</b>	Analysis suggests that if employers took advantage of the reduction in cap to 2.5% it could lead to average savings of the order of £250 million per year (2007/08 prices), although savings could reach as much as £400 million in the long term.		
	£ 0				
	<b>Average Annual Benefit</b> (excluding one-off)				
	£ 250 million		<b>Total Benefit (PV)</b>	<b>£ 4.4 billion</b>	
Other <b>key non-monetised benefits</b> by 'main affected groups' Employer sponsoring schemes - increased profits because of lower pension scheme costs could result in: higher wages for employees; increased employment and improved company viability. Scheme members - may increase likelihood of continuing defined benefit pension provision by employer.					
Key Assumptions/Sensitivities/Risks All employers sponsoring defined benefit schemes will implement the new requirement. Long term inflation is 2.9%.					
Price Base Year 2007	Time Period Years 43	<b>Net Benefit Range (NPV)</b> £ 0	<b>NET BENEFIT (NPV Best estimate)</b> £ 0		
What is the geographic coverage of the policy/option?			Great Britain		
On what date will the policy be implemented?			January 2009		
Which organisation(s) will enforce the policy?			PO and Courts		
What is the total annual cost of enforcement for these organisations?			£ Negligible		
Does enforcement comply with Hampton principles?			Yes		
Will implementation go beyond minimum EU requirements?			No		
What is the value of the proposed offsetting measure per year?			£ 0		
What is the value of changes in greenhouse gas emissions?			£ Negligible		
Will the proposal have a significant impact on competition?			No		
Annual cost (£-£) per organisation (excluding one-off)		Micro	Small	Medium	Large
Are any of these organisations exempt?		No	No	N/A	N/A
<b>Impact on Admin Burdens Baseline</b> (2005 Prices) (Increase - Decrease)					
Increase of	£ N/A	Decrease of	£ N/A	<b>Net Impact</b> £ N/A	
Key:		Annual costs and benefits: Constant Prices		(Net) Present Value	

Summary: Analysis & Evidence					
Policy Option: Repeal safeguarded rights		Description: Repeal current requirements which relate to safeguarded rights			
COSTS	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups'		
	<b>One-off</b> (Transition)	<b>Yrs</b>			
	£ 0		<b>Total Cost (PV)</b>	£ 0	
	<b>Average Annual Cost</b> (excluding one-off)				
£ 0		Other <b>key non-monetised costs</b> by 'main affected groups'			
BENEFITS	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups'		
	<b>One-off</b>	<b>Yrs</b>			
	£ 0		<b>Total Benefit (PV)</b>		
	<b>Average Annual Benefit</b> (excluding one-off)				
£ Negligible		£ Negligible			
Other <b>key non-monetised benefits</b> by 'main affected groups'					
Administrators of pension schemes -they would not have to ensure that safeguarded rights are treated differently from pension credits rights. Individuals will have more flexibility when transferring their rights and when the pension credit comes into payment.					
Key Assumptions/Sensitivities/Risks 10,000 pension sharing orders per annum . 4,000-5,000 pension sharing orders per year affected by the change					
Price Base Year 2007	Time Period Years 43	<b>Net Benefit Range (NPV)</b> £ 0	<b>NET BENEFIT (NPV Best estimate)</b> £ 0		
What is the geographic coverage of the policy/option?			Great Britain		
On what date will the policy be implemented?			October 2008		
Which organisation(s) will enforce the policy?			HMRC		
What is the total annual cost of enforcement for these organisations?			£ Negligible		
Does enforcement comply with Hampton principles?			Yes		
Will implementation go beyond minimum EU requirements?			No		
What is the value of the proposed offsetting measure per year?			£ 0		
What is the value of changes in greenhouse gas emissions?			£ Negligible		
Will the proposal have a significant impact on competition?			No		
Annual cost (£-£) per organisation (excluding one-off)		Micro	Small	Medium	Large
Are any of these organisations exempt?		No	No	N/A	N/A
<b>Impact on Admin Burdens Baseline</b> (2005 Prices) (Increase - Decrease)					
Increase of	£ N/A	Decrease of	£ N/A	<b>Net Impact</b>	£ N/A
Key:		Annual costs and benefits: Constant Prices		(Net) Present Value	



# Chapter 6: Improving trust in private pensions

## Objectives

- 6.1 The Bill makes a number of changes relating to the Pension Protection Fund and the Pensions Regulator to improve the administration of the institutions and enhance the service they provide to their various customers.
- 6.2 These changes are informed by the operation of the institutions since they opened for business in April 2005, and reflect the need to continue to build trust and confidence in private pensions as a means of saving for retirement, without placing undue burdens on the institutions' customers, including employers who provide occupational pension schemes and those who administer them.

## Rationale for reform

### **The Pension Protection Fund**

- 6.3 The operation of the Pension Protection Fund has revealed a small number of areas where improvements to legislation will enable the Pension Protection Fund to operate more efficiently, and provide enhanced and more equitable treatment for its customers. These changes are necessary to ensure that recipients of Pension Protection Fund payments receive pension compensation which properly reflects the level of pension they would have received at that point in their life. They will also ensure that divorcing couples are able to share compensation within a settlement in a similar way as they would if a scheme had not entered the Pension Protection Fund.

### **The Pensions Regulator**

- 6.4 The Pensions Regulator replaced the Occupational Pensions Regulatory Authority as part of a new risk-based and proportionate regulatory regime, which applies greater scrutiny where it considers member benefits are most at risk. In the course of developing its role, functions and powers over the past two years, an area has been identified where an amendment to legislation will enable the Pensions Regulator to deliver its statutory objectives more effectively.

## Pension Protection Fund compensation sharing on divorce

6.5 Currently, on divorce or dissolution of a civil partnership, any pension assets are valued and may be shared or transferred as part of the divorce settlement. The Pension Protection Fund is not a pension scheme, and therefore these provisions do not apply. It is therefore intended that provision be made for valuing compensation, issuing court Orders in respect of the compensation, and the implementation of those Orders by the Pension Protection Fund.

### **Costs and benefits**

#### ***Public sector***

6.6 Detail concerning the method of calculation of shares of compensation and the information that the Pension Protection Fund will need to provide will be contained in secondary legislation. The Pension Protection Fund does not expect that the administrative costs will be significant and, other than set-up costs the legislation will provide, the costs of implementing compensation sharing Orders for couples will be met by those couples.

#### ***Individuals***

6.7 This proposal will enable couples undergoing divorce or dissolution of marriage or civil partnership to reach greater independence and fairer settlements by enabling the courts to share Pension Protection Fund compensation in the same way that they can currently share pensions. This will allow members of couples who have had less opportunity to contribute to their own pension, especially women, carers and disabled people, or those who have had lower earnings, to acquire a share of the compensation due to their ex-spouse where this forms one of the couple's more significant assets.

#### ***Employers***

6.8 There will be no impact on employers.

#### ***Gender impacts***

6.9 Men are more likely to have significant levels of Pension Protection Fund compensation than women<sup>141</sup>. This means that men are more likely to have reduced compensation following a divorce. However, this would only be as a result of a fair settlement with their ex-spouse.

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<sup>141</sup> Pages 75 and 76 of the Pension Protection Fund Annual Report and Accounts 2006/07 HC1018. The report shows that both for deferred members and pensioner members of schemes in the Pension Protection Fund in March 2007 men outnumbered women by more than 10 to 1. The Pension Protection Fund expect the trend to continue to show men outnumbering women by a large degree given the nature of the schemes in assessment.



6.10 This measure is likely to lead to enhanced opportunities for women and carers who are less likely to have entitlements to Pension Protection Fund compensation in their own right.

### ***Race and disability impacts***

6.11 It is not anticipated that there will be any negative impacts for any ethnic group or for disabled people.

### ***Competition impact***

6.12 There should be no effect on business other than the requirement for some parts of the legal profession to familiarise themselves with the new legislation.

## **Operation of the Pension Protection Fund**

6.13 The measures intended to improve the operation of the Pension Protection Fund and to improve the service it delivers are:

- to ensure that when the recipient of a pension sharing order becomes entitled to compensation from the Pension Protection Fund, the level of that compensation reflects revaluation to take account of inflation where appropriate;
- to ensure that where the level of compensation due can be adjusted upwards and downwards to reflect increases and reductions in the level of pension payments had the scheme not entered the Pension Protection Fund;
- to ensure that compensation can be delayed where doing so would be in the interests of the member and would ease the administration of the Pension Protection Fund;
- to allow for the actuarial adjustment to enhance the value of delayed payments;
- to clarify the definition of “normal pension age”; and
- to clarify the meaning of “admissible rules” used to define the level of compensation paid.

### **Costs and benefits**

#### ***Public sector***

6.14 Taken together these measures will provide the opportunity for small operational efficiencies within the Pension Protection Fund and will ensure that a lack of clarity in the legislation does not lead to additional burdens being placed on the Fund.

**Individuals**

6.15 These measures will ensure a more equitable distribution of compensation with a closer match between compensation being paid and the benefits the person would have got from their pension scheme if it had not entered the Fund.

**Employers**

6.16 The measures will help ensure there are no unforeseen demands placed on the administration levy.

**Race and disability impacts**

6.17 It is not anticipated that there would be any negative impacts for any gender, ethnic group or for disabled people, but the measure is likely to lead to enhanced opportunities for women, disabled people and carers.

**Competition impact**

6.18 The measures will help ensure there are no unforeseen demands placed on the administration levy.

## Interest on late payment of the Pension Protection Fund Levy

6.19 The Pension Protection Fund is responsible for collecting the Pension Protection Levy – £675 million for 2007/08<sup>142</sup> – which is invested in order to fund compensation to members of eligible defined benefit pension schemes whose employers have gone insolvent.

6.20 A significant amount of the Pension Protection Levy is paid late by schemes. While some payments of the 2006/07 levy were paid late because of a dispute or review of the levy invoice, over £100 million<sup>143</sup> was still paid late where there was no dispute or review of the Levy invoice.

6.21 At present, there is no power in the Pensions Act 2004 for the board of the Pension Protection Fund to deter delayed payment of the Pension Protection Levy. The Bill therefore makes provision to charge a prescribed rate of interest on late payment of the Pension Protection Levy and for the waiver of interest charges in certain circumstances.

6.22 Any interest payments received would be available for investment as part of the Pension Protection Fund, and compensate for the investment income foregone by the Fund. However, we would expect the fact that interest would be

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<sup>142</sup> 2007/08 Pension Protection Levy Estimate Consultation Document, published December 2006.

<sup>143</sup> Data on late payment of the Pension Protection Levy was provided to DWP during September 2007.

charged on late payments would reduce the incidence of late payment, as schemes would aim to pay Levy bills more promptly to avoid paying interest.

6.23 The rate of interest will be included within regulations on which we would consult with the pensions industry and other interested parties. If the Pension Protection Fund were to have charged interest on late payments where there was no dispute or review (referred to in paragraph 6.20) and at a rate of interest of, say, the current Bank of England base rate of 5.75 per cent, interest charges would have amounted to around £600,000.

6.24 For similar reasons, the Bill will make provision to enable interest to be charged on late payment of the Fraud Compensation Levy, the Pension Protection Fund Administration Levy, the Pension Protection Fund Ombudsman Levy and the General Levy.

6.25 We recognise that there will be circumstances where there are legitimate reasons for late payment of levies and regulations will provide for the waiving of interest charges in prescribed circumstances.

## **Costs and benefits**

### ***Public sector***

6.26 It is anticipated that the Pension Protection Fund will collect interest relating to late payment of the Pension Protection Levy and the Fraud Compensation Levy. The set-up costs of implementing the administration of interest charging for these levies has yet to be determined but are estimated to be in the region of around £15,000 and would be recovered from pension schemes through the Pension Protection Fund administration levy, of which £15,000 would form a very small proportion, i.e. less than 0.1 per cent based on current rates.

6.27 We anticipate that the Pensions Regulator will collect interest relating to late payment of the Pension Protection Fund administration Levy, the Pension Protection Fund Ombudsman Levy, and the General Levy. The set-up costs of implementing the administration of interest charging for these levies has yet to be determined but are estimated to be between £10,000 and £20,000. The set-up costs will be recovered through the General Levy which funds the administrative costs of the Pensions Regulator, of which this amount would form a very small proportion, and less than 1 per cent based on current rates.

### ***Employers***

6.28 Pension schemes that are eligible for Pension Protection Fund compensation will only be subject to interest charges in the event of late payment of levies. They may also incur an administrative cost of paying interest in relation to the late payment of levies, but this would be negligible in terms of the total running costs of a pension scheme.

***Race and disability impacts***

6.29 There will be no negative impacts of this proposal on any ethnic group or for disabled people.

***Competition impact***

6.30 It is anticipated that there will be no impact on competition between businesses.

## Powers of the Pensions Regulator: Amendment to Section 231 of the Pensions Act 2004

**Summary of policy**

6.31 The Pensions Regulator's powers in respect of the funding requirements for private sector defined benefit schemes are set out in Part 3 of the Pensions Act 2004 (the 2004 Act). They include the power to direct the actuarial assumptions which must be used in the calculation of a pension scheme's technical provisions (defined as the amount required, on an actuarial calculation, to make provision for the scheme's liabilities).

6.32 The 2004 Act lists the specific circumstances in which these powers may be exercised, and these include a failure to comply with the requirements relating to the preparation of a scheme's statement of funding principles, its schedule of contributions, or any recovery plan. A breach of any of these requirements allows the Pensions Regulator to use any of its scheme funding powers.

6.33 Doubt has been expressed as to whether the legislation currently allows the Pensions Regulator to use its scheme funding powers where the sole concern is that the actuarial assumptions used in the calculation of a scheme's technical provisions do not appear to have been chosen prudently by the trustees. This amendment clarifies that the Regulator can use its scheme funding powers where the actuarial assumptions chosen by the trustees do not appear to be prudent.

**Costs and benefits**

6.34 This amendment is intended to ensure that the Pensions Regulator has appropriate powers to allow it, in cases of concern, to be more effective in persuading the trustees and the sponsoring employer to agree to the use of prudent actuarial assumptions. This would not alter the total costs of providing the pension benefits promised by the scheme in the long term, although it could in some cases result in higher contributions in the shorter term, and hence affect the pace at which the pension benefits under the scheme are funded. Apart from this effect (which could apply to the small number of funded public services schemes which are subject to Part 3 of the 2004 Act), the amendment is not expected to have any impact on public finances.

**Gender, race, disability and competition impact**

6.35 The amendment is not expected to give rise to any gender, race, disability or competition impact issues.



# Chapter 7: Further simplifying State Pensions

## Consolidation of Additional Pension rights

### Objectives

- 7.1 The Pensions Act 2007 introduces measures that will help simplify basic State Pension and State Second Pension. The measures mark a step forward in helping people understand their pension entitlement. However, the three entitlements that make up state pension: basic State Pension, the state second pension schemes and Pension Credit still remain complex in some areas and further work needs to be done to simplify those.
- 7.2 The proposals outlined here will provide a further and significant simplification of the state second pension schemes. The proposals build on the Pensions Act 2007 and are consistent with the Government's five tests for reform; to promote personal responsibility, be fair, simple, affordable and sustainable.

### Rationale

- 7.3 Having put in place measures to simplify State Second Pension in the future this Bill takes steps to simplify the three additional State Pension schemes that today's workers may have contributed to in the past and in which they will have a stake in for many years to come. At the moment these pension accruals are only notional and cannot be given a firm cash value until a contributor retires.
- 7.4 We propose that the three schemes are brought to account after the end of the 2011/12 tax year and given a cash valuation. This cash amount will be revalued by earnings until the contributor retires. People of working age will then know the amount of pension their past contributions have paid for and will be able to estimate in a straightforward way the value of the pension they will be able to build up in the future. Simplifying additional State Pension in this way, combined with an earnings uprated basic State Pension, will provide contributors with a much better understanding of their retirement income from the State and its value to them as a foundation for private saving.

### Summary of proposals

- 7.5 The key proposal is to consolidate the existing additional State Pension rights currently being built up by people of working age. All additional State Pension rights for this group up to 2011/12 will be converted into a cash valuation. This valuation will be based on the rules and calculations that would have been normally applied to the accruals in a contributor's account at the point they

reached State Pension Age. Only those reaching State Pension age after 5 April 2020 will have their additional State Pension consolidated in this way. The valuation would be posted onto contributor's accounts and we intend to bring forward an amendment during the passage of the Bill to enable the cash valuation to be revalued in line with earnings up to State Pension age.

- 7.6 When the Additional Pension is calculated, it will be necessary to reduce that amount for those who have been contracted out, in line with what currently occurs at State Pension age. The method of calculating this reduction will be unchanged, with the exception of the period from April 1978 to March 1997. During this period contracting out was taken into account by deducting any entitlement to a Guaranteed Minimum Pension<sup>144</sup> from the Additional State Pension (the contracted-out deduction). Guaranteed Minimum Pension rules mean that the correct rate of the contracted out deduction is not known until State Pension age, as it can change depending upon the circumstances of an individual. It is our intention to bring forward an amendment during the passage of the Bill which will fix the contracted out deduction in relation to the Additional State Pension using a method which is actuarially fair. This proposal will not disturb any entitlement that a contributor has to a private pension.

## **Costs and benefits**

### ***Government***

- 7.7 The proposal in effect rolls up calculations from three distinct pension benefits into a single cash sum. It will no longer be necessary for DWP staff to have a working knowledge of the complex rules of these benefits – Graduated Retirement Benefit (1961-1975), the State Earnings Related Pension Scheme (1978-2002) and unreformed State Second Pension (2002-2012). This simplification cannot start until pay as you earn (PAYE) returns are made for the 2011/12 tax year and at this stage we have not fully identified all the opportunities this will have on reducing complexity in our business processes. In the long-term, it will be possible to close the old schemes and at the same time remove the complex calculation routines, the guidance and the need for staff to be trained in these benefits. Without these changes the need for continued detailed knowledge could extend to the end of the century.

### ***Individuals***

- 7.8 The proposals, together with reforms of State Second Pensions in the Pensions Act 2007, will enable contributors to have a much clearer picture of their State Pension outcomes, both the value of pension accrued to date and projected forward. The reforms of the contracted-out deduction which we are proposing to bring forward during the passage of the Bill will, for the first time, provide contributors with a valuation of the amount of additional State Pension they will receive in retirement. These proposals will help provide a key element of

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<sup>144</sup> Guaranteed Minimum Pension is the statutory minimum a Defined Benefit scheme must be designed to produce for anyone contracted-out in the years 1978 to 1997.



information to contributors so that they can make fully informed savings decisions.

### **Gender, race, disability impact**

7.9 These reforms will affect additional State Pension rights previously and currently accrued until the Pensions Act 2007 reforms take effect. They will apply equally to all affected pension accrual records irrespective of gender, race or disability.

### **Competition impact**

7.10 The reforms will not raise any concerns regarding competition because the objective does not relate to specific markets or companies. The amount of pension payable by private and occupational pension schemes will be unaffected by this proposal.

### **Implementation and delivery plan**

7.11 Plans on implementing the changes have yet to be finalised. However, flexibility over the conversion window will be required, with commencement possible from the end of the 2011/12 tax year. We do not expect to bring forward the calculation for anyone who reaches State Pension age before 2020.

## **Pension Credit simplification – assessed income period run-on**

### **Objectives**

7.12 This proposal removes the need to review older pensioners' changes in circumstances in respect of their Pension Credit entitlement and is part of a package of simplification measures aimed at:

- improving the customer experience;
- optimising operational efficiency;
- providing more accurate assessments; and
- reducing fraud and error.

### **Rationale**

7.13 When Pension Credit was introduced in October 2003 the cases that migrated from Minimum Income Guarantee were set an automatic assessed income period of between five and seven years. During this period recipients of Pension Credit

were not required to declare increases in capital and other similar changes of circumstance. The assessed income period on these cases will start to mature between October 2008 and October 2010. In addition all new claims with assessed income periods from October 2003 rolling forward will have an assessed income period maturing from October 2008 onwards.

7.14 This proposal will reduce the number of cases requiring a review after April 2009 thus reducing the administrative burden the Pension Service will experience. It will also reduce the level of intrusion and uncertainty that the customer experiences every five years with having to provide the same level of information and verification as at the outset of their claim.

### **Summary of proposals**

7.15 An assessed income period is a specific period of up to five years during which time the Pension Credit customer's or partner's capital or savings are deemed to stay the same. Those customers aged 65 and over can have an assessed income period if they satisfy the relevant qualifying conditions.

7.16 The assessed income period is a fundamental part of the design of Pension Credit. It was introduced to reduce the level of intrusion normally associated with an income-related benefit. During the assessed income period the customer is not required to report changes to capital or savings.

7.17 When the assessed income period matures there is a requirement to then consider the setting of another assessed income period. At this point the customer is asked to provide information and evidence of their current circumstances. This process is similar to what the customer would have needed to provide at the outset of their claim.

7.18 To reduce the level of intrusion further and to simplify procedures, we are proposing to remove the limit of five years on the assessed income period for those customers aged 80 and over and for those customers who have an assessed income period spanning their 80th birthday. This means that the assessed income period will continue to run-on and will therefore remove the need for the Pension Service to review the case and the customer to provide detailed information every five years.

### **Costs and benefits**

#### ***Costs to Government***

7.19 The financial impacts of this policy are relatively small. Currently, increases in the value of individual's capital holdings over the assessed income period are taken into account when their Pension Credit entitlement is recalculated at the end of an assessed income period. For those individuals affected by the policy this will no longer be the case and consequently the policy will incur a small cost to the Government in terms of benefit expenditure; estimated to be less than £1 million in each of the years 2009/10, 2010/11 and 2011/12 (2007/08 prices).

7.20 However, the policy will also alleviate the administrative burden on the Pension Service creating some savings for the Government. Under the current system, when an assessed income period matures the case is reviewed and the customer asked to provide detailed information regarding their income and capital. The policy removes the need for this process and is estimated to create administrative savings of around £4 million in 2009/10, around £3 million in 2010/11 and around £1 million in 2011/12<sup>145</sup>.

### ***Individuals***

7.21 Older customers will experience less intrusion. Additionally, an increase in capital over an assessed income period will not reduce their income. Evidence suggests that only a small minority of customers are likely to benefit in this way.

### ***Employers***

7.22 This proposal is not expected to have any impact on employers.

### **Gender, race and disability impact**

7.23 The change will affect all of those pensioners aged 80 or over with an assessed income period and those who have an assessed income period that spans their 80th birthday. The effect will be dependant upon their age and whether they have an assessed income period. It would apply equally irrespective of gender, race or disability.

### **Competition impact**

7.24 This proposal will not raise any concerns regarding competition because the objective does not relate to specific markets or companies.

### **Implementation and delivery plan**

7.25 Plans on implementing the changes have yet to be finalised. Based on current assumptions the earliest implementation date for this change would be April 2009.

7.26 The qualifying conditions that govern when an assessed income period is appropriate in Pension Credit are covered in the State Pension Credit Act 2002. Any changes to the qualifying conditions must be enacted through legislation and in this case must be primary legislation. There is no non-regulatory alternative to legislation.

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<sup>145</sup> 2007/08 prices, rounded to the nearest £million.



## Chapter 8: Polish War Pensions

### Objective

- 8.1 To remove the residency restriction from the Polish Resettlement Act 1947 to enable pensions to continue to be paid to beneficiaries who become resident in Poland from 1 May 2004 (the date of Poland's accession to the EU).

### Rationale

- 8.2 The Polish Resettlement Act 1947 permitted a scheme to be set up to provide pensions to members of the Polish Forces injured or killed in service under British command in World War II and to widows, surviving civil partners, children, parents and other dependants of members of the Polish Forces deceased in consequence of service during World War II. The Pensions (Polish Forces) Scheme 1964 makes such provision. Both the Act and the Scheme contain a residency restriction which provides that payments to beneficiaries of the scheme will be terminated and cannot be re-instated if the beneficiary is, or becomes, resident in Poland. This was based on the assumption that the post-War Polish Government (which did not accept liability to pay pensions to those living outside Poland) would meet the cost of pension awards to pensioners who returned to Poland.
- 8.3 It is recognised that, in accordance with Article 18 of the EC Treaty, EU citizens must not be impeded in exercising their free movement and residence rights in the territory of EU Member States. It is therefore necessary to remove the residency restriction from the Act to enable pensions to continue to be paid to beneficiaries who become resident in Poland from 1 May 2004 (the date of Poland's accession to the EU).

### Summary of proposals

- 8.4 Remove the residency restriction from the Act to enable pensions to continue to be paid to beneficiaries who become resident in Poland from 1 May 2004 (the date of Poland's accession to the EU) and to amend the 1964 scheme accordingly.

### Costs and benefits

- 8.5 The number of beneficiaries who moved to Poland after 1 May 2004 is not currently known but is considered to be very small. The total number of beneficiaries remaining under the scheme is currently 730. As they are elderly and well settled in the UK it is unlikely that significant numbers will return to Poland. The costs of the amendment are therefore expected to be minimal.

## Implementation and delivery plan

- 8.6 Following amendment of the Act to remove the residency restriction, consequential amendments to the pension scheme will follow and an exercise will be undertaken to identify the small number of pensioners who may have returned to Poland since 1 May 2004 in order to re-commence their benefits and, where necessary, to make backdated payments in respect of the period from 1 May 2004 to the date of commencement of the amendment.

## Section 168 of the Pensions Act 1995 Amendment on Civil Partnerships

- 8.7 Section 168 of the Pensions Act 1995 provides for the effect of remarriage on receipt of war pensions for surviving spouses. Currently it refers only to remarriage but should in fact refer to remarriage or entering into a further civil partnership.
- 8.8 This amendment does not provide a new right for a surviving civil partner to receive a war pension. The Ministry of Defence prerogative instruments, which are the legal basis for the Armed Forces Pension Scheme 1975, already make provision for payment of pensions to surviving civil partners, and for the effect of subsequent civil partnerships, but they cross reference to section 168 for the definition of the termination of civil partnerships. This amendment will regularise the general position.

# Chapter 9: Amendment to section 59(5ZA) of the Social Security Pensions Act 1975

## Objective

9.1 The proposed amendment is aimed at correcting a technical error in section 59(5ZA) of the Social Security Pensions Act 1975 and at extending the scope of section 59(5ZA) to cover civil partners. Section 59(5ZA) deals with the interface between requirements to index public service pension schemes and requirements to index Guaranteed Minimum Pensions. Guaranteed Minimum Pensions accrued where a member contracted out of the Second State Pension between the years 1978 and 1997.

## Rationale

9.2 Pensions from public service schemes are uprated under the provisions of the Pensions Increase Act 1971 and Section 59 of the Social Security Pensions Act 1975. Section 59(5ZA) was inserted to prevent an element of double indexation of Guaranteed Minimum Pensions in relation to the pension payable to widows and widowers by public service schemes. Guaranteed Minimum Pensions are part of pensions accrued as a result of public service scheme member contracting out of the state earnings related pension between the years 1978 and 1997. Double indexation of Guaranteed Minimum Pensions can occur when Guaranteed Minimum Pensions are increased by both public service pension scheme requirements and DWP requirements for index-linking state pensions.

9.3 Widows and widowers of members of public service schemes inherit half of their late spouses' Guaranteed Minimum Pensions, but in the case of widowers only the Guaranteed Minimum Pensions in respect of service since April 1988. Civil partners inherit Guaranteed Minimum Pensions rights similarly to widowers in public service schemes.

9.4 As it currently stands, section 59(5ZA) does not operate correctly because it does not recognise the differences in Guaranteed Minimum Pensions entitlements between widows and widowers and it does not cover civil partners. This could result in some widowers not receiving full indexation on part of their pension and in some civil partners being entitled to double indexation on part of their pension.

## Summary of proposals

- 9.5 Section 59(5ZA) of the Social Security Pensions Act 1975 needs to be rectified so as to bring uprating for widowers and civil partners in public service schemes in line with uprating provided for widows.

## Costs and benefits

- 9.6 The amendment corrects a technical anomaly in existing legislation, section 59(5ZA) of the Social Security Pensions Act 1975, so that it correctly reflects the different Guaranteed Minimum Pensions entitlements of widows and widowers for the purpose of calculating pensions increases. It also extends section 59(5ZA) to prevent an element of double indexation from applying to civil partners of public service scheme members.

## Implementation and delivery plan

- 9.7 The amendment once in place will provide for widowers and civil partners to be treated on the same basis as widows in relation to the requirements to prevent double indexation of Guaranteed Minimum Pensions by public service pension schemes.



## Annex A: Impact on small firms

A.1 The Government's proposals for automatic enrolment with a minimum employer contribution and the introduction of the personal accounts scheme have been welcomed by employers' groups as necessary measures to guard against pensioner poverty and to promote private saving. In particular, employers recognise the long-term economic benefits of addressing the issue now, rather than deferring until the problems become acute. They also recognise that increased private pension saving wealth will benefit the economy as a whole.

A.2 The Government's reform programme continues to place employers at the heart of pension provision, and can only be successful with the support and involvement of employers. Many employers in the UK are already making a substantial contribution to their own pension schemes and are supporting their employees in saving for retirement. The Government's policies already support this in many ways and we want to ensure our reform package also contributes to this. However, for the reforms to be fully successful, those employers who do not already support pensions also need to play a role.

### Issues faced by the smallest firms

A.3 Most existing businesses in the UK are small and almost all new firms created each year are small enterprises. There are around 1.2 million private sector enterprises in the UK. Small enterprises, with less than 50 employees represent 97 per cent of private sector enterprises and 37 per cent of private sector jobs. In contrast there are only 6,000 firms employing more than 250 people<sup>146</sup>.

A.4 Small firms are likely to have a number of structural differences compared to their larger counterparts. Notably, these are:

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

A.5 Figure 1.2, in chapter 1, shows that employees working in large firms are also more likely to be in a pension scheme and to be receiving relatively generous employer contributions compared to those working for small and medium-sized firms.

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<sup>146</sup> Small and Medium-Sized Enterprise Statistics 2006.

A.6 The Government recognises the challenges faced by small firms. We are keen to ensure that such firms are not disadvantaged by the reforms and are able to fulfil their new duties in the same way as larger firms.

## What is a small firm?

A.7 There is no single definition of a small or medium sized firm. The simplest approach is to regard all businesses having fewer than 250 employees as being Small and Medium-Sized Enterprises (SMEs), which is the definition we have used in this annex. In our analysis we have broken down this definition further into:

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

## The impact on small firms

A.8 Like all firms, SMEs will face contribution and administrative costs as a result of the reforms.

### Contribution Costs

A.9 SMEs are expected to bear around £1.6 billion of contribution costs once contributions have been fully phased in. This equates to £400 million for micro firms, £800 million for small firms and £400 million for medium sized firms<sup>147</sup>. This represents, on average, a 1 per cent rise in total labour costs for all SMEs<sup>148</sup>.

A.10 Employers have several ways of managing the additional costs of the reforms including: absorbing the increase through overheads (28 per cent), increased prices (21 per cent), or lower wage increases (14 per cent), or restructure their workforce (8 per cent). These themes were repeated among smaller employers. A small number of employers (10 per cent) suggested that they might encourage their employees to opt out<sup>149</sup>. As discussed in chapter 4, the compliance regime will aim to mitigate this risk.

### Administrative costs

A.11 In the December 2006 Regulatory Impact Assessment, the DWP made a commitment to set up a cross-government group to refine the Government's

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<sup>147</sup> Source: DWP modelling.

<sup>148</sup> This percentage is higher than that presented in Chapter 2 as the analysis in this Annex excludes large firms, which have larger total labour costs.

<sup>149</sup> Research by BMRB International for DWP (Grant C, Fitzpatrick A, Sinclair P and Donovan JL, forthcoming in 2008, *Employers' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*).

assessment of the administrative cost impact of the reforms on employers. This work has been completed and a summary of the group's report can be found in Annex G.

A.12 Our latest estimates suggest that SMEs will incur an administrative cost of around £306 million in the first year and around £92 million in following years. Table 2.7 in chapter 2 illustrates this in more detail. This is the cost to employers of enrolling eligible workers into either personal accounts or a qualifying scheme.

A.13 While the working group has carefully considered all the assumptions underlying these estimates there is some degree of uncertainty around the actual cost of these reforms to employers. Consequently they may be subject to change as the detailed design of the scheme is developed, as new research evidence becomes available and as we continue to consult with employers.

A.14 Table A.1 below summarises the impact on small firms.

<b>Table A.1: Costs for small firms</b>			
Firm size (number of employees)	1-4	5-49	50-249
Number of firms	800,000	371,000	27,000
Number of employees	1,100,000	2,400,000	1,300,000
Year 1 administrative costs (£ million)	167	105	34
Ongoing administrative costs (£ million)	59	28	6
Costs of minimum employer contribution (£ million) Year 3	400	1,100	500
Percentage of labour costs Year 3 onwards	1.1%	1.2%	0.7%

Source:

Number of firms Small and Medium-Sized Enterprise (SME) Statistics 2006.

Employer contribution DWP analysis based on Employers' Pension Provision Survey 2005, Small and Medium-Sized Enterprise (SME) Statistics 2005, and Annual Survey of Hours and Earnings 2005

Administrative costs based on DWP modelling

Notes:

- Figures for employer contributions rounded to the nearest £100 million;
- Numbers of firms is rounded to the nearest 1,000 and employees to the nearest 100,000;
- Numbers in the table may not match to totals in text due to rounding;
- Numbers of firms are rounded to two significant figures;
- Contributions are based on 2007/08 earnings and employment, they are not uprated to take into account earnings growth until 2012. Uprating for earnings growth would increase the costs in nominal terms, but not as share of labour costs or earnings terms; and
- Figures for administrative costs are rounded to nearest million and are expressed in 2007/08 prices.

## Consultations with representative groups

A.15 DWP has undertaken extensive consultation with small businesses and their representatives on the proposals assessed in this impact assessment. DWP's consultation has included discussions with the following employer groups to take into consideration the views of small firms:

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

A.16 DWP has also been in consultation with the Department for Business, Enterprise and Regulatory Reform as part of the working group on administrative burden and also sought their views on engagement with employers. Beyond consultation with these groups, DWP has also consulted with small employers directly. The focus of this work was a small employer seminar which took place on 18 October 2006. Since then other seminars on compliance and employer policy have also been attended by small employers.

A.17 The process of consultation will continue as the Personal Accounts Delivery Authority develops its detailed implementation plans for the personal accounts scheme. The Authority has announced that it will set up an employers' panel which will act as a conduit for gathering opinion on the operation and implementation of the scheme. This will ensure that participating employers' interests are taken into account in the development of the scheme.

## Employers' response to the legislation

A.18 DWP research with employers<sup>150</sup> shows that there is considerable support for the idea of automatic enrolment with an employer contribution among employers of all sizes. Overall, six in ten (58 per cent) employers felt these reforms were a

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<sup>150</sup> Research by BMRB International for DWP (Grant C, Fitzpatrick A, Sinclair P and Donovan JL, forthcoming in 2008, *Employers' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*).

good idea and only three in ten employers (27 per cent) thought they were a bad idea.

A.19 Looking at smaller employers, 60 per cent of micro-employers thought the reforms were a good idea and only 24 per cent thought they were a bad idea. Similarly, 50 per cent of employers with 5-49 employees thought the reforms were a good idea and only 36 per cent of these firms thought they were a bad idea.

A.20 A number of small employers and their representative groups have suggested that small employers may require more help than larger employers in adjusting to their new duties and have called for financial support. The Government recognises that the smallest businesses will have the most difficulty in managing the additional costs. At this stage the Government is focused on ensuring that the design of the personal accounts scheme is appropriate before any further support for employers is considered. This would be a decision for future Governments based on the fiscal position at the time.

A.21 There was consensus amongst small businesses that the process for employers around personal accounts should be kept as simple as possible and involve as little employer input as possible.

## Policies to aid small employers

A.22 The Government has sought wherever possible to minimise the impacts of personal accounts on employers, including small firms.

A.23 The Government's aim to minimise the burden of reform on employers has led to a series of proposals. These include:

- reassurance that minimum contributions will not be raised by placing these in the primary legislation;
- the minimum employer contribution will be phased in over three years;
- the criteria by which schemes will qualify for automatic enrolment will be as simple and as straightforward as possible;
- those employers that provide higher contributions or benefits will be allowed to operate a deferral period;
- the personal accounts scheme will use a delivery model that minimises the burden on employers;
- the Personal Accounts Delivery Authority's delivery principles will include minimising burdens on employers; and
- an employers' panel will be set up to feed in views to the personal accounts scheme trustees.

## Compliance

- A.24 As part of its consultation with employers, the DWP has sought views on the design of the compliance regime. Stakeholders have shown general agreement with the main principles of a proportionate, risk-based approach, which makes use of automated data-matching processes rather than relying solely on individuals to take action themselves through whistle-blowing or an employment tribunal.
- A.25 The compliance regime may come into contact with small employers by three main routes: education and information, the registration requirement, and further interventions such as letters or investigations for some employers.
- A.26 An effective communication strategy will be used to minimise the need for enforcement action by making sure that employers know what they are required to do and when to do it. The Government recognises that this will be particularly important for smaller employers who are currently less likely to be making contributions to workplace pensions schemes and therefore will be unfamiliar with the steps required to comply.
- A.27 While some elements of the burdens created by the reform, such as contribution costs, vary considerably by firm size, the cost of registering will be dependent on the number of pay as you earn (PAYE) schemes that the employer operates and therefore needs to register. Although the largest employers are more likely than small ones to have more than one PAYE scheme, the vast majority of PAYE schemes are run by small employers. For this reason, most of the total cost of registration falls upon the large number of small employers. Table A.2 shows the estimated cost of registration.

<b>Table A.2: Estimated administrative cost to firms of registering with the compliance body</b>			
Firm size (number of employees)	1-4	5-49	50-249
Cost per employer of registration (£)	9	5	8
Cost of registration in Year 1 (£ million)	6.9	1.9	0.2
Cost of registration in subsequent years (£ million)	0.3	0.0	0.0
% of total administrative costs from reform in Year 1	4%	2%	1%
% of total administrative costs from reform in subsequent years	0.4%	0.1%	0%

Source: DWP modelling

- A.28 Further costs will occur if an employer does not fulfil their legal obligation and is subject to an enforcement activity. However, the automated follow-up to the registration process should ensure that small employers who are initially unaware

of their duties, or experience a delay in registering will have a further opportunity to become compliant and avoid becoming subject to more intrusive investigation at a later date.

A.29 One of the key aims of the compliance regime is to ensure that there is a level playing field for employers. It will aim to prevent non-compliant employers from gaining an unfair advantage over the majority who will meet their new duties. For small employers that face strong competitive pressures, this will be a valuable part of the Pension Regulator's new work.





# Annex B: Competition assessment

## Summary

B.1 The proposals in this Bill affect the market for pension saving, and specifically the market for pensions organised through the employer. There are also indirect impacts on other parts of the pensions market, for example on the pensions market for the self-employed. The principle that personal accounts should complement and not replace existing pension provision has been central to the policy development process.

B.2 Key markets that would be affected by these reforms are those that operate in and around private pension provision. These include:

- pension providers (including long-term life insurance companies), who market and sell pension products;
- providers of administrative services supporting pension provision;
- investment and fund managers, who manage funds invested by individuals, companies and governments, in equities, bonds, derivatives and so on; and
- financial intermediaries, such as independent financial advisers.

B.3 Other sectors could also be affected, for example the banking sector, but only to the extent that they provide some or all of the services covered by the sectors listed above, for example through fund management or the provision of administrative services.

B.4 As the proposals set minimum standards for pension contributions provided by the employer, it is possible that the policy will have an impact on the labour market, and competition for workers. This is because it will impact on the package of benefits that employers are able to offer employees to join and remain in the firm.

## Current nature of competition

B.5 The pension provider market is relatively concentrated, with the top five firms having around 60 per cent of the market share, the top 10 having 82 per cent and the top 20 around 95 per cent<sup>151</sup>.

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<sup>151</sup> Association of British Insurers, *Long-term Insurance Net Premium Income Rankings*, Updated September 2007.

B.6 The fund management market is less concentrated, with the top five firms covering 30 per cent of the market and the top 10 having 48 per cent<sup>152</sup>. Sub-markets are also fairly concentrated, for example the largest three group stakeholder pension providers have around 50 per cent of the market and the largest seven providers around 90 per cent<sup>153</sup>. However, it needs to be noted that there are also a number of smaller players: the Pensions Regulator has 45 providers in total on their register of stakeholder pensions.

B.7 The financial intermediaries sector is predominantly made up of small firms. Of the 44,000 independent financial advisers, 93 per cent are in firms that normally consist of one or two advisers<sup>154</sup>. Employers also play a major role as a provider of occupational schemes, part of which may be outsourced to a third party administrator or pension provider. In addition, the pension provider and fund management markets are characterised by a high degree of vertical integration with several of the top ten investment management firms being owned by, or part of a wider group with, a top 20 pension provider.

## Rationale for intervention

B.8 The current private pensions market, where individuals contract with providers via financial intermediaries, is generally characterised by a relatively small and informed consumer base. However, the target group for these reforms is currently not being well served by this market for two main reasons:

- on the supply side, pension providers require relatively high contribution levels and/or high levels of persistency to recover the costs of distributing, setting up and administering pension products. Normally, pension providers tend to use advisers to sell pensions through employers. Therefore, the smaller the size of a company and the lower the wages, the less profitable it is for providers to sell to these employers. Evidence found that the cut-off point above which it is usually profitable to sell pensions is a firm size of 20 employees<sup>155</sup>; and
- on the demand side, individuals, particularly in the target market for these reforms, tend to exhibit low levels of financial literacy and inertia in financial decision making<sup>156</sup>. This leads a low level of demand for pension products<sup>157</sup>. In addition, the 2002 Sandler report found that consumer weakness is an 'extremely important feature' of the retail savings industry<sup>158</sup>. The inability of consumers to exert meaningful influence leads to the current industry structure and means that there is little incentive for providers to reduce costs or improve service.

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<sup>152</sup> Investment Management Association, *Asset Management Survey*, July 2007  
[www.investmentfunds.org.uk/press/2007/20070731-01.pdf](http://www.investmentfunds.org.uk/press/2007/20070731-01.pdf).

<sup>153</sup> CRA International, *Competition in Personal Accounts*, November 2006.

<sup>154</sup> Kempson E and Collard S, 2005, *Advice on pensions and saving for retirement: Qualitative research with financial intermediaries*, DWP research report 289.

<sup>155</sup> CRA International, *Competition in Personal Accounts*, November 2006.

<sup>156</sup> *A New Pension Settlement for the Twenty-First Century: The Second Report of the Pensions Commission*, 2005.

<sup>157</sup> CRA International, *Competition in Personal Accounts*, November 2006.

<sup>158</sup> Sandler R, 2002, *Medium and long-term retail savings in the UK: A review*, HM Treasury.

## Impact of proposals

B.9 We have assessed whether these reforms have any of the following impacts, in line with the guidance from the Office of Fair Trading:

- directly limiting the number or range of suppliers;
- indirectly limiting the number or range of suppliers;
- limiting the ability of suppliers to compete; and
- reducing suppliers' incentives to compete vigorously<sup>159</sup>.

B.10 As explained in detail in the following sections, increasing savings through automatic enrolment and minimum employer contributions and extending pension provision through the creation of personal accounts should not reduce competition in the affected markets.

## Increasing saving – impact of automatic enrolment and a minimum employer contribution

### Impact on the pensions market

B.11 Automatic enrolment and a minimum employer contribution will have beneficial impacts on competition in the pensions market. The expansion of pension provision is likely to make it more profitable to provide pensions to small firms as the participation and contribution rates within these firms are likely to increase. Employers will be able to choose between different forms of provision to fulfil their obligations.

B.12 Employers with qualifying workplace personal pension arrangements will be able to continue with these arrangements for existing members. However, given that automatic enrolment into workplace personal pensions is not possible, we are also considering whether to provide for an alternative route for these employers to discharge their duties to enrol eligible non-participating workers. Ensuring that the requirements are as equivalent as possible between different types of pension scheme will encourage vigorous competition across the market and avoid one form of provision having an unfair advantage over other types of scheme.

### Impact on the product market

B.13 The policies for automatic enrolment and the minimum employer contribution will apply to all employers, so there is a possibility of some impact on the product

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<sup>159</sup> Office of Fair Trade, August 2007, *Completing competition assessments for impact assessments: Guideline for policy makers* [http://www.offt.gov.uk/shared\\_offt/reports/comp\\_policy/oft876.pdf](http://www.offt.gov.uk/shared_offt/reports/comp_policy/oft876.pdf).

market. These new employer duties are likely to increase pension costs for employers, particularly those who do not currently provide pensions and those who currently have low levels of pension membership among their workforce. Around one-fifth (21 per cent) of employers said they thought they would deal with these increased costs through price increases for consumers<sup>160</sup>. The level of competition in each segment of the market will determine the degree to which employers are able to do this. This will be influenced by the change in costs for other employers in the same market.

### Impact on the labour market

- B.14 The minimum employer contribution should not reduce competition between employers in the labour market. The policy levels up employer contributions at the lower end of the labour market where it is not currently used as an instrument to attract or retain employees and still provides a level playing field for employers to compete in the labour market.
- B.15 Employers can compete for and retain the best employees by offering higher than the minimum contribution as part of their remuneration package. This is important in a dynamic labour market such as the UK's, where higher employer pension contributions can be used as a means of differentiating between different employers. Maintaining employer competition and remuneration flexibility will maintain market forces in recruitment and job retention and help to sustain the high level of job mobility in the UK.

## Extending provision – impact of personal accounts

- B.16 The purpose of personal accounts is to provide employees who have no pension provision in the workplace at present with access to low-cost pension saving. The creation of personal accounts introduces an additional pension vehicle into the market to enable employers to fulfil their new obligation to their employees.
- B.17 The design features of personal accounts will mean that it is targeted at the part of the market that is currently not well served. The contribution limit and ban on transfers and the limited range of investments and benefits available, will make it less attractive to those employees who already run high quality pension schemes.
- B.18 Thus it is possible that the future pensions market will consist of a diverse range of product offerings. Personal accounts will serve the gap in the market of pension provision mainly consisting of small employers who are not engaged with pension provision, and so will seek to do the minimum. The existing pension market will continue to serve engaged employers who wish to provide more than the minimum.

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<sup>160</sup> Research by BMRB International for DWP (Grant C, Fitzpatrick A, Sinclair P and Donovan JL, forthcoming in 2008, *Employers' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*).

- B.19 Charges in workplace pensions vary widely depending on characteristics of the employer, employees and features of the scheme or scheme type. When an employer is engaged in pension provision, the scheme is likely to have charges equivalent to between 0.4 and 1 per cent of the individual's accumulated pension saving. Where there are at least 50 employees participating in the scheme, an employer contribution, a scheme set up without the payment of commission and good persistency as a result of low staff turnover, charges can be around 0.5 per cent of the individual's accumulated pension saving. On the other hand, it is possible for charges to be around the level of the stakeholder charge cap<sup>161</sup> if the business is not attractive because of its size, low contributions, or potential lack of persistency. If the firm is small, and overall contribution levels are low, then charges are likely to be higher than in a large firm with higher contribution levels.
- B.20 Given that individuals in the target group may not be particularly price sensitive to financial services products in general<sup>162</sup> and pensions products in particular, another process is required to help deliver low charges to these consumers. This will be achieved in personal accounts by the scheme's trustees working in members' best interests, ensuring that firms compete for time-limited contracts. Therefore, the nature of competition will be different in the personal accounts scheme than in the overall market, with providers competing for contracts to serve this segment of the market rather than directly for consumers. There are unlikely to be losses of dynamic competition and product innovation, as they will be achieved through contract specifications and periodic renewal<sup>163</sup>.
- B.21 Personal accounts will be delivered using capabilities procured from the private sector. Best practice will be adhered to throughout the procurement process to ensure effective and fair competition for contracts. All contracts will be let in accordance with the Public Contracts Regulations (2006). The appointments to the Personal Accounts Delivery Authority will be made with regard to securing best value for money. The personal accounts scheme will be set up as a trust as this is the best way to provide transparency.
- B.22 The decumulation process will utilise the existing methods of competition in the annuity market through giving individuals the use of the open market option to choose their annuity.
- B.23 Some savings in the personal accounts scheme will be diverted from existing savings products, for example those who are currently saving in more expensive pensions via a disengaged employer, or in an individually sold personal pension or diversion of savings from other types of savings products. This will have some impacts on competition for wider savings products if individuals choose to move savings from more flexible products into personal accounts. Based on a literature survey carried out by PricewaterhouseCoopers we estimate that up to 40 per cent of contributions into the personal accounts scheme could be diverted from other

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<sup>161</sup> Stakeholder charges are capped at 1.5 per cent for the first ten years and 1 per cent thereafter.

<sup>162</sup> Sandler R, 2002, *Medium and long-term retail savings in the UK: a review*, HM Treasury.

<sup>163</sup> CRA International, 2006, *Competition in personal accounts*.

forms of saving.<sup>164</sup> However, the different product features means that competition for savings across the whole range of options will continue.

## Conclusion

B.24 The introduction of automatic enrolment and minimum employer contributions should not have negative impacts on competition in the pensions, labour and product markets. Instead, they will lead to an expansion of the existing market, with an estimated 6-9 million more workers saving or saving more in workplace pension schemes.

B.25 Personal accounts will introduce a new low-cost pension to individuals who are not effectively served by the market at present. They will be delivered through the private sector, who will be able to compete for contracts. Where an employer is able to choose between personal accounts and an existing provider, this will represent an extension in choice that could reduce charges and improve services. Overall, the personal accounts scheme has been designed to complement rather than replace existing pension provision.

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<sup>164</sup> John Hawksworth, PricewaterhouseCoopers, 2006, *Review of research relevant to assessing the impact of the proposed National Pensions Savings Scheme on household savings*, DWP Research Report No 373.

## Annex C: Gender impact assessment

- C.1 There is a legacy of pensions inequality between men and women. A number of factors have historically caused inequalities in both private and state pension income.
- C.2 Labour market patterns have affected women's ability to build up state pension entitlements, as well as the level and frequency of private pension contributions they make.
- C.3 Reforms to the state pension system, implemented by the Pensions Act 2007, will significantly contribute to making future pensioners, and in particular women, better off. However, for many people the State Pension only provides part of the income they aspire to. Additional private provision will therefore continue to be vital. By providing a solid foundation for private saving, a more generous and inclusive state pension system is a significant factor in encouraging more pension saving.
- C.4 At present, women have lower rates of participation in private pension schemes than men. Around 54 per cent of female employees contribute to a private pension compared to around 58 per cent of men. Women are more likely to be lower earners and to work for small firms, two groups that are not currently served well by the pensions market. Women are more likely than men to have broken work histories, affecting the length of time spent in a job, and are more likely to be affected by behavioural barriers associated with pension saving.
- C.5 These reforms will provide employees with access to a workplace pension scheme, which provides employer and government contributions. They will ensure equality of access to a workplace scheme of a minimum standard, giving many millions of men and women the opportunity to build up a private pension.
- C.6 The latest Government estimates show that 9-11 million people will be eligible for automatic enrolment into a qualifying pension scheme of which we expect 3.5-4 million to be women<sup>165</sup>. There are more men than women in the group eligible for automatic enrolment. This is because women are more likely to be economically inactive, to work in the public sector (with very high participation rates) or to earn less than £5,035 per year. These estimates represent around two thirds of private sector employees aged over 22 and earning more than around £5,000 for both men and women. Many of these individuals will be gaining access to a workplace pension scheme for the first time.
- C.7 Based on recent research<sup>166</sup>, we expect higher rates of participation for women than men<sup>167</sup>. In this study, 65 per cent of men and 73 per cent of women

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<sup>165</sup> DWP modelling based on EPP 2005 and ASHE 2005

<sup>166</sup> Research by Ipsos MORI for DWP (Smith P, Webb C, Pye J, Robey R, and Jeans D, forthcoming in 2008, *Individuals' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*).

said they would probably or definitely stay in the scheme. Taking these participation rates into account we expect around an additional 2-3 million women and 2.5-4.5 million men to participate in a workplace pension scheme. In addition, around half a million women who are already saving will benefit from a higher employer contribution.

- C.8 The introduction of personal accounts and the employer duty to automatically enrol will give employers a choice about where workers will be automatically enrolled<sup>168</sup>. In total we estimate that 4-7 million individuals will participate in personal accounts, and that 1-3 million of them will be women. We expect higher levels of personal accounts participation in subsequent years.
- C.9 Alongside the improvements in women's labour market position relative to men, these reforms will offer substantial opportunities for women to build up private pension savings in their own right. Automatic enrolment will be particularly useful in helping overcome inertia and lack of confidence in making financial decisions, which appear to be more significant barriers for women in saving in a pension scheme. If women save earlier as a result of these reforms this will also help to substantially increase their final pension entitlement at retirement.
- C.10 Due to improvements in state pensions, the large majority of men and women can expect to benefit from saving into a workplace pension scheme, with good incentives to save at the point they are automatically enrolled. This is true for those who expect to work or care for most of their working life, irrespective of their income level. Individuals can expect to gain both in financial terms and in the security offered by building up their own pension assets.
- C.11 Full details of the analysis can be found in the accompanying document *Gender Impact Assessment of Pension Reform, December 2007*.

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<sup>167</sup> US research into 401(k) schemes also suggests that automatic enrolment has the greatest impact on those workers among whom participation rates are otherwise low, including people on low incomes and women. Madrian and Shea, 2002, in Mundell and Sunden, 2004, *Coming up short: The challenge of 401(k) plans*, The Brookings Institute.

<sup>168</sup> The assumptions on employer choice are explained in detail in Annex F.



## Annex D: Race assessment

D.1 These reforms are likely to have a proportionately more positive impact on black and minority ethnic (BME) groups than on individuals from white ethnic backgrounds. This reflects the fact that these groups are over-represented in the target group for automatic enrolment.

D.2 Table D.1 shows that employees in BME groups are over-represented amongst those with lower earnings.

<b>Table D.1: Distribution of employees by earnings and ethnic group</b>					
	Less than £5,000	£5,000 to £14,999	£15,000 to £24,999	£25,000 to £32,999	£33,000 and over
<b>White</b>	<b>8%</b>	<b>29%</b>	<b>31%</b>	<b>15%</b>	<b>18%</b>
Male	3%	17%	35%	19%	26%
Female	13%	41%	27%	10%	9%
<b>BME</b>	<b>9%</b>	<b>31%</b>	<b>30%</b>	<b>13%</b>	<b>16%</b>
Male	9%	28%	31%	12%	20%
Female	10%	35%	30%	14%	11%
<b>All</b>	<b>8%</b>	<b>29%</b>	<b>31%</b>	<b>14%</b>	<b>18%</b>
Male	4%	18%	34%	18%	26%
Female	13%	40%	27%	10%	10%

Source: UK Family Resources Survey, 2005/06

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

D.3 White and BME women are both under-represented in the population of employees earning over £33,000 and over-represented in the population earning less than £5,000, highlighting that this is a gender issue as well as a race issue.

D.4 Table D.2 shows that employees in BME groups are also less likely to be contributing to a private pension than white individuals: in 2005/06, 28 per cent of individuals aged 22 to State Pension age from BME groups contributed to a private pension, compared with 45 per cent of individuals from white ethnic backgrounds.

Table D.2: Proportion of employees saving for a pension by earnings and ethnic group						
	Less than £5,000	£5,000 to £14,999	£15,000 to £24,999	£25,000 to £32,999	£33,000 and over	All
White	15%	42%	62%	76%	83%	45%
BME	7%	22%	50%	61%	72%	28%

Source: UK Family Resources Survey, 2005/06

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

D.5 When the Personal Accounts Delivery Authority moves into the more detailed design and delivery phase, it will be required to conduct detailed race impact assessments on its specific proposals to ensure that the details of the scheme are suitable for people of all ethnic backgrounds.

## Annex E: Disability assessment

- E.1 People with disabilities are a diverse group. There are major variations within the group of disabled people, depending on their impairments, and the severity of those impairments, as well as their characteristics<sup>169</sup>. In addition, the data sources available use different definitions of disability.
- E.2 Data from the Labour Force Survey show that, in quarter one of 2007, the employment rate for people described as long-term disabled was 50 per cent, while for those people not long-term disabled the employment rate was 80 per cent.
- E.3 Table E.1 shows that, generally, employees who are disabled are equally represented in the target group of moderate to low earners (£5,000 to £33,000), although they are over-represented amongst those earning between £5,000 and £15,000.

Table E.1: Distribution of employees by earnings and disability status					
	less than £5,000	£5,000 to £14,999	£15,000 to £24,999	£25,000 to £32,999	£33,000 and over
Not disabled	7%	28%	31%	15%	19%
Disabled	14%	34%	29%	12%	11%

Source: Family Resources Survey 2005/06

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

- E.4 Twenty three per cent of disabled people aged 22 to State Pension age are currently participating in a private pension, compared with 47 per cent<sup>170</sup> of people in this age group who are not disabled. However, the picture is different when only employed people are considered. Employees who are disabled are slightly less likely than non-disabled employees to participate in a private pension, with 55 per cent of disabled employees contribute to a private pension, compared with 58 per cent of employees who are not disabled.
- E.5 Overall we expect the reforms to have a similar impact on disabled people in employment as on those who are not disabled.

<sup>169</sup> R. Berthoud, *The employment rates of disabled people*, DWP Research Report No 298.

<sup>170</sup> Family Resources Survey 2005/06.

E.6 When the Personal Accounts Delivery Authority moves into the detailed design and delivery phase it will be required to conduct detailed disability impact assessments on its specific proposals to ensure that the details of the scheme are suitable for people with different impairments.

# Annex F: Explanation of participation estimates

F.1 Chapter 2 sets out our current working assumptions for participation in workplace pension schemes following the introduction of these reforms. These showed:

- 6-9 million people newly participating or saving more in workplace pensions;
- 4-8 million new savers in workplace pensions;
- 4-7 million individuals participating in personal accounts; and
- 1-2 million additional people saving or saving more in existing pension schemes.

F.2 This annex provides a more detailed explanation of how these estimates have been derived and how they have changed compared to the initial estimates presented in the December and May 2006 Regulatory Impact Assessments.

F.3 Our latest estimates have been updated to reflect more recent information on pension provision and population projections and new evidence on likely individual and employer behaviour and policy developments since the December 2006 White Paper.

F.4 A significant degree of uncertainty remains about the number of new savers that will result from these reforms and where they will be saving. This will on trends in pension provision between now and 2012, the future responses of employers and individuals and the detailed policy decisions that will need to be made in the run up to implementation of these reforms. For these reasons, our estimates are generally presented as broad ranges.

F.5 The Government will continue to monitor trends in pension provision, the economic context in which these reforms will be introduced and the attitudes of employers and individuals. As we move towards 2012, we will continue to update these estimates in light of the new evidence we receive.

## Method

F.6 Our working assumptions on the impact of these reforms have been arrived at using the following methodology:

- projecting trends in pension provision between now and 2012;

- estimating the number of people likely to be eligible for automatic enrolment;
- applying assumptions about where employers will choose to automatically enrol their workers;
- applying assumptions about the proportion of workers who will continue to save in the pension into which they are automatically enrolled; and
- estimating the number of people who are not automatically enrolled but choose to opt in to a workplace pension.

F.7 This annex explains these steps in turn and sets out the resulting estimates of the number of people saving in workplace pensions following reform.

## Projecting trends in pension provision to 2012

F.8 It is unlikely that pension provision in 2012 will look exactly the same as it does today. To illustrate the way in which it could change we have used some simple scenarios based on recent past trends. The estimates of participation presented in the May and December 2006 Regulatory Impact Assessments did not take account of trends in pension provision between now and 2012 but instead presented estimates of likely participation in the long run, based on the pensions landscape at that point in time.

F.9 The best source of information on trends in membership of occupational pension schemes is the Occupational Pension Schemes Survey<sup>171</sup>. Figure F.1 shows how the level of active membership in defined contribution schemes and in open and closed defined benefit schemes changed between 1995 and 2006.

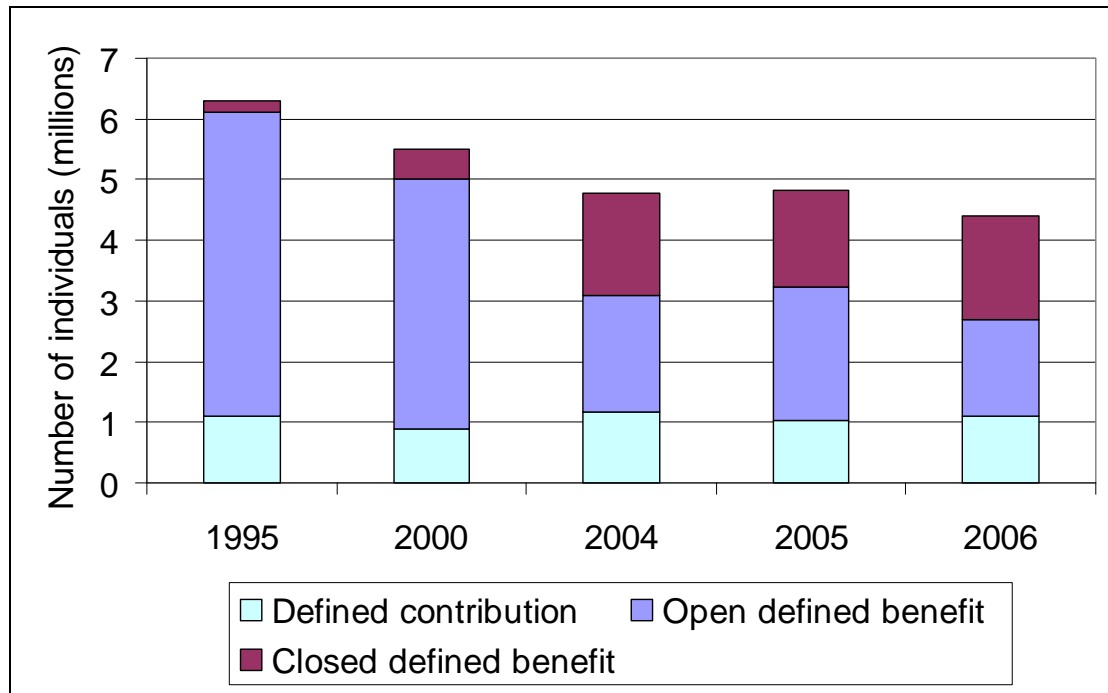
F.10 There has been a significant decline in active membership of defined benefit schemes since 1995, along with an increasing proportion of active members in closed schemes. The rate of decline in membership has been around 4 per cent per year since 1995 and 5 per cent since 2000. Active membership of defined contribution schemes has been broadly constant throughout the period, at around 1 million.

F.11 Figure F.2 shows that since 2001, when stakeholder pensions were introduced, there has been a steady growth, of around 5 per cent per year, in the number of people saving in employer sponsored personal pensions.

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<sup>171</sup> [www.statistics.gov.uk/downloads/theme\\_population/Occ-pension-2006/OPSS\\_Annual\\_Report\\_2006.pdf](http://www.statistics.gov.uk/downloads/theme_population/Occ-pension-2006/OPSS_Annual_Report_2006.pdf)

**Figure F.1: Active membership of private sector occupational pension schemes**



Source: Occupational Pensions Scheme Survey 1995/2006

**Figure F.2: Membership of employer sponsored personal pensions**



Source: HMRC pension statistics, Tables 7.3 and 7.4, available online at <http://www.hmrc.gov.uk/stats/pensions/menu.htm>

F.12 In addition to specific data on employer sponsored pension provision, we know that overall pension participation has declined. The proportion of people of

working age saving for retirement has declined from 45 to 42 per cent since 2000<sup>172</sup>.

F.13 We have used three scenarios to illustrate the uncertainty surrounding the trends in pension provision between now and 2012. These are not intended to be forecasts of how pension provision could evolve over the next five years, but guides to the possible range of outcomes.

- In the constant scenario, overall pension participation remains level. The decline in defined benefit provision continues at the same rate as that observed between 1995 and 2006, but is offset by the continuing growth of employer sponsored personal pension schemes, which are assumed to have an employer contribution of at least 3 per cent;
- In the declining pension provision scenario, defined benefit provision declines more quickly, at the rate seen since 2000, and there is no offsetting growth in employer sponsored personal pensions; and
- In the growing pension provision scenario, we see no further decline in defined benefit provision and a continued growth in employer sponsored pension provision.

F.14 In all three scenarios we assume that the number of people participating in occupational defined contribution schemes grows in line with population growth. The results of these scenarios are summarised in Table F.1.

## Estimating the number of people eligible for automatic enrolment

F.15 Using data from the Employer Pension Provision Survey 2005 and the Annual Survey of Hours and Earnings 2005, we have estimated the number of people eligible for automatic enrolment in 2005. Individuals will be eligible for automatic enrolment if they are aged between 22 and State Pension age, earning more than £5,035 (in 2006/07 earnings terms) and are not participating in a workplace pension with employer contributions of 3 per cent or more (or the equivalent for defined benefit schemes).

F.16 Using the latest population projections from the Government Actuary's Department<sup>173</sup>, we are able to project the number of employees who will be eligible for automatic enrolment in 2012. Table F.1 sets out how these assumptions combine with our pension projection scenarios to estimate the number of people eligible for automatic enrolment in 2012. This produces a working assumption of 9-11 million workers who could be eligible for automatic enrolment in 2012. This compares to the May and December 2006 Regulatory

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<sup>172</sup> Source: Family Resources Survey.

<sup>173</sup> <http://www.statistics.gov.uk/pdfdir/pproj1007.pdf>



Impact Assessments estimates of 10.1 million workers automatically enrolled into personal accounts and 0.7 million workers into existing provision.

**Table F.1: Summary of pension provision projections under the three scenarios**

	Number of eligible workers in qualifying schemes (million)		Proportion of workers in qualifying schemes		Number of people eligible for automatic enrolment (million)
	2005	2012	2005	2012	2012
Constant scenario	5	5	35%	35%	10
Declining pensions	5	4	35%	30%	11
Growing pensions	5	6	35%	39%	9

Source: DWP analysis based on the Employers Pension Provision survey 2005 and the Annual Survey of Hours and Earnings 2005

Notes: Figures cover the UK and are rounded to nearest million.

## Employer choice

F.17 Employers will be able to choose where to enrol their workers. They could extend membership in their existing schemes, set up a new scheme using an existing provider, or enrol some or all of their workers into the new personal accounts scheme.

F.18 In the May and December 2006 Regulatory Impact Assessments it was assumed that:

- 20 per cent of eligible workers in firms offering an employer contribution of 3 per cent or more would be enrolled into the existing scheme;
- all eligible workers in firms offering an employer contribution of less than 3 per cent would be enrolled into personal accounts; and
- all those participating in schemes with more than 3 per cent employer contributions would continue to save in that scheme.

F.19 These assumptions have been updated in light of recent policy developments, including clarification of the qualifying tests for existing schemes and the latest research on employers' likely reactions to the Government's pension reforms<sup>174</sup>, as set out in Table F.2. This suggests that employers are more likely than we previously assumed to enrol eligible non-members and new workers into existing

<sup>174</sup> Research by BMRB International for DWP (Grant C, Fitzpatrick A, Sinclair P and Donovan JL, forthcoming in 2008, *Employers' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*).

schemes. In addition, some employers who are currently not providing pensions have said that they will set up a new scheme in which to enrol their workers. Most employers currently making contributions of 3 per cent or more said they will maintain their current scheme for existing members. However, the survey also suggests that a few employers may choose to move some current members out of their existing scheme and into personal accounts. Overall, the research suggests there will be an increase in the number of people saving in existing schemes. Based on these findings, we have updated our assumptions on where individuals could be enrolled.

Table F.2: Where employers said they would enrol employees (%)					
	Providing a scheme with 3% or more employer contributions		Providing a scheme with 0-3% employer contribution		Currently not providing
	Existing members	New members	Existing members	New members <sup>1</sup>	
Existing scheme only	87	43	67	20	15
Existing scheme and personal account pension scheme	N/A	9	N/A	10	8
Personal accounts scheme only	4	34	7	46	39
Other	1	3	10	6	9
Don't know	7	10	13	17	28

Source: Research by BMRB International for DWP (Grant C, Fitzpatrick A, Sinclair P and Donovan JL, forthcoming in 2008, *Employers' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*).

Note: 1. These figures are based on where employers say they will automatically enrol both current employees who are non-members and new employees.

F.20 As there is a degree of uncertainty around how employers will react to the reforms in 2012, we have used three different scenarios for the proportion of employers enrolling their employees into existing schemes. Overall, the proportion of eligible employees who are enrolled into existing schemes ranges from around 20 per cent to around 55 per cent. We have assumed that the requirements placed on employers to fulfil their new duties will be equivalent regardless of whether they choose to operate an occupational or a personal pension scheme.

F.21 The impact of these assumptions is to increase the overall number of people in existing pension provision compared to our previous estimates, although a relatively small number of workers who otherwise would have been saving in a qualifying employer scheme are now automatically enrolled into personal accounts.

F.22 Our current working assumption is that between 2 and 3 million workers will be enrolled into existing pension schemes which meet the qualifying criteria. Around

1 million workers, who are in schemes with less than 3 per cent employer contributions, will see an increase in contributions to at least the new minimum. The May and December 2006 Regulatory Impact Assessments estimated that 0.7 million people would be enrolled into existing schemes and no one would benefit from higher contributions in an existing scheme.

F.23 For personal accounts, our working assumption is that between 5 and 7 million workers who are not currently saving in a workplace pension scheme will be automatically enrolled. In addition, around 0.5 million workers who are participating in a pension scheme with less than 3 per cent contribution from the employer, and between 0.5 and 1 million workers<sup>175</sup> participating in a scheme with more than 3 per cent employer contribution will be automatically enrolled into personal accounts.

F.24 In the May and December 2006 Regulatory Impact Assessment it was assumed that 10.1 million people would be automatically enrolled into personal accounts. The fall in the number of people being automatically enrolled into personal accounts is largely because more employers are now assumed to enrol their workers into existing forms of pension provision.

## Participation

F.25 A survey of individuals' attitudes and likely reactions to personal accounts was recently carried out on a representative sample of individuals who would be eligible for automatic enrolment<sup>176</sup>. This survey asked people whether they thought they would stay in or opt out of personal accounts and provides an update of the participation assumption based on the characteristics of the target group. The results are shown in table 2.2 in chapter 2.

F.26 Based on this new evidence, taking account of the age distribution of those most likely to be automatically enrolled, and making assumptions about the possible behaviour of those who responded 'probably' and 'don't know' or 'it depends', we estimate a central expected participation rate of around 75 per cent with a range of 55 and 80 per cent. We also assume that if someone is already saving in a pension scheme they will continue to do so, including the situation where their employer chooses to move them to personal accounts.

F.27 This participation rate is broadly similar, but a little higher, to that used in the May and December 2006 Regulatory Impact Assessments, which assumed that around one third of those enrolled would opt out. This was drawn from a variety of different sources but did not directly relate to the characteristics of the group eligible for automatic enrolment.

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<sup>175</sup> The upper end of this range uses a fairly extreme assumption about employer choice in relation to existing scheme members. It assumes that all employers in the DWP employer survey who said that they did know what they would do in relation to existing members would enrol existing members into personal accounts.

<sup>176</sup> Research by Ipsos MORI for DWP (Smith P, Webb C, Pye J, Robey R, and Jeans D, forthcoming in 2008, *Individuals' attitudes and likely reactions to the personal account reforms 2007; Report of a quantitative survey*).

- F.28 These new participation rates lead to a working assumption of between 3 and 8 million workers participating in personal accounts. However, in reality, the extremes of this range are very unlikely, as they would require the most extreme outcomes for all the key assumptions<sup>177</sup> to simultaneously take place. Further analysis suggests a narrower range of 4-7 million personal accounts members, based on a 99 per cent confidence interval.
- F.29 We also estimate that around 1-2 million additional people will be saving or saving more in a qualifying pension scheme other than personal accounts.
- F.30 Overall, we estimate that between 6 and 9 million workers will be saving more in workplace based pension schemes as a result of these reforms. This includes around 1.5 million workers benefiting from a higher employer contribution and 4 to 8 million people newly saving in personal accounts or an alternative qualifying scheme.

## Other savers

- F.31 It will be possible for self-employed people to opt in to personal accounts. We have assumed that some of those who become self-employed after 2012 will choose to join personal accounts instead of considering a personal pension. However, we expect this number to be relatively small. This is partly because the self-employed won't be able to benefit from a matching employer contribution. It is also because many of those currently self-employed are likely to have taken out a personal pension, have an alternative retirement plan, or wish to prioritise building up their business. Some of the features of personal accounts, such as a contribution limit and a more restricted range of benefits, will also make them less attractive than existing products on the market.
- F.32 We estimate that in the long run around 10 per cent of the self-employed will participate in personal accounts, which is around 0.3 million people. This is a revision from the 0.8 million estimate in the May and December 2006 Regulatory Impact Assessments.
- F.33 In addition, personal accounts members who take a career break, for example due to caring responsibilities, will be able to continue making contributions. The requirement that someone who is not currently working but wishes to contribute, must have previously worked and been a personal accounts member, means that the numbers of such contributors will start from a low base. Based on evidence about current participation in pensions by those not in paid employment<sup>178</sup>, we assume that around 1 per cent of this group, or 0.1 million people, will participate in personal accounts. This is a reduction from the estimate of 0.7 million in the May and December 2006 Regulatory Impact Assessments. The previous estimate was higher as the requirement for a link to previous employment had not been clarified at the time.

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<sup>177</sup> In relation to pension trends, employer choice about where to enrol and individual participation rates

<sup>178</sup> DWP modelling based on the Family Resources Survey 2005/06

F.34 The other group who may apply to join their employer's scheme are those in work but not eligible for automatic enrolment, either because they have earnings below the threshold or are outside the age band. We assume that, in the long run, around 0.2 million workers outside the automatic enrolment age group will opt in. This is also based on evidence about their current participation in private pension saving<sup>179</sup>.

F.35 Taking account of all these groups, we estimate that around 0.6 million people could choose to opt in to personal accounts, rather than be automatically enrolled. As there will be a slow build up of these participants in personal accounts, there will only be around 0.2 million people who opt in to personal accounts in 2012.

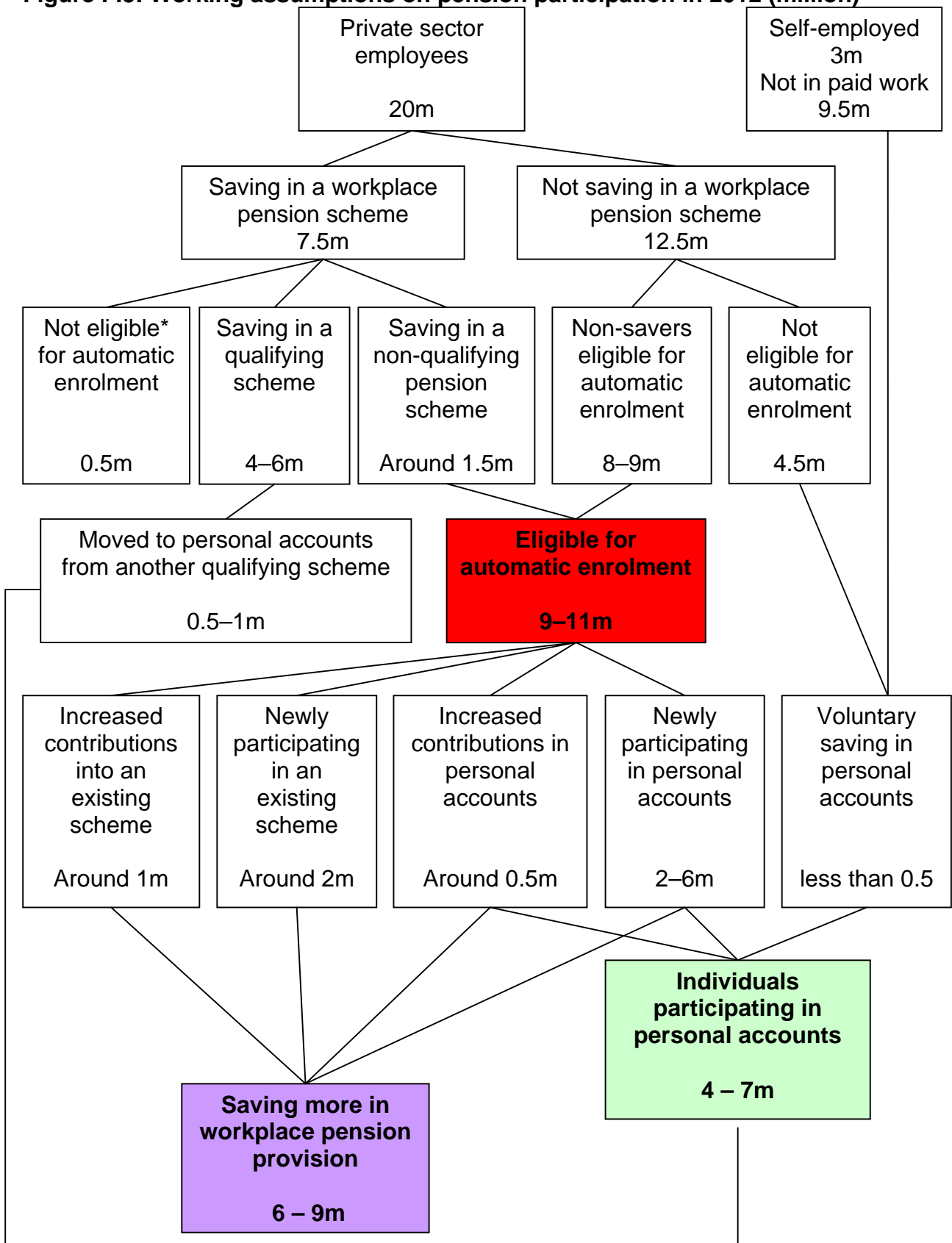
## Estimate of pension participation following the reforms

F.36 Figure F.3 below sets out our working assumptions of the number of people eligible for automatic enrolment and the likely number of people participating in personal accounts and existing pension schemes in 2012.

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<sup>179</sup> DWP modelling based on the Annual Survey of Hours and Earnings 2005 and the Labour Force Survey 2005

Figure F.3: Working assumptions on pension participation in 2012 (million)



Source: DWP modelling.

Notes: Numbers are rounded to the nearest 0.5 million and therefore may not sum.

\* Not eligible means not aged between 22 and State Pension age or earning less than £5,035 (in 2006/07 earnings terms).

## Annex G: Estimates of the employer administrative costs of reform

G.1 In the December 2006 White Paper *Personal accounts: a new way to save*, the Government presented initial estimates of the administrative costs of personal accounts on employers. We announced that we would be setting up a cross-government working group to refine our estimates of the cost impacts on employers.

G.2 The working group, comprising economists from DWP, the Enterprise Directorate at the Department for Business, Enterprise and Regulatory Reform (BERR), and the Better Regulation Executive, had the following remit:

- to scrutinise and refine the administrative burdens on employers associated with automatic enrolment into personal accounts;
- to determine and support the assumptions to which our cost estimates are most sensitive;
- to identify workable and affordable measures to reduce the administrative burden of personal accounts on businesses; and
- to identify any changes needed in the implementation of personal accounts to reduce burdens on business.

G.3 The Government is keen to support the continuation of existing pension provision and has developed a set of qualifying tests to enable employers to use their existing pension schemes to fulfil their automatic enrolment obligations. Our analysis has therefore been extended to include those employers who might choose to automatically enrol their workers into a qualifying workplace pension scheme other than personal accounts. As discussed in Annex F, our latest research suggests that more employers than previously expected will choose to automatically enrol workers into existing schemes.

G.4 The work of the group has led to an improved set of employer cost estimates. However, given that there remain a number of years before implementation of the reforms, there is inevitably a degree of uncertainty surrounding our estimates. Our estimates are dependent on assumptions around employer and employee behaviour between now and 2012. For example, changes in the proportion of employers who choose to use a qualifying scheme other than personal accounts, in the proportion of employers who decide to administer their payroll systems in-house relative to those choosing to outsource such functions to a third party supplier or in the proportions of individuals choosing to opt out, could impact upon our cost estimates.

G.5 The remainder of this annex summarises the conclusions of the working group, presents our latest estimates of the administrative costs to employers and explains the methodology and key assumptions that underpin them.

## December 2006 estimates

G.6 In the December 2006 Regulatory Impact Assessment, the Government estimated that total administrative cost to employers of using the personal accounts scheme to fulfil their automatic enrolment duty would be £291 million in the first year and £96 million per year thereafter on an ongoing basis. Table G.1 shows how these costs vary by firm size.

<b>Table G.1: Estimates of the administrative costs of personal accounts, published in the December 2006 Regulatory Impact Assessment</b>		
	Cost in Year 1 (£ million)	Ongoing annual cost in future years (£ million)
Large firms	36	5
Medium firms	39	4
Small firms	120	27
Micro firms	94	60
<b>Total costs</b>	<b>291</b>	<b>96</b>

Source: DWP modelling

Notes:

- Costs are expressed in 2005/06 prices;
- Year 1 costs include the costs of implementing personal accounts.

## The work of the group

G.7 In the course of its work to refine these estimates, the group:

- systematically reviewed all of the assumptions underlying the estimates presented in 2006;
- incorporated evidence from the latest data sources including the Annual Survey of Hours and Earnings and evidence from a recent DWP survey of employer attitudes and likely responses to reform<sup>180</sup>; and
- commissioned two new research projects on the costs to employers:

<sup>180</sup> Research by BMRB International for DWP, Grant C, Fitzpatrick A, Sinclair P and Donovan JL, *Employers' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*, forthcoming in 2008. This is a nationally representative survey of approaching 2400 private sector employers across a range of size bands.



- a series of focus groups with employers of different sizes to help validate our estimates of the cost of internally administering monthly contributions<sup>181</sup>. This research found our estimates to be broadly accurate and, if anything, slightly high; and
- a small telephone-based survey to help establish the additional costs of administering monthly contributions to employers who currently outsource their payroll functions<sup>182</sup>.

## Methodology

G.8 This analysis takes account of the range of processes and functions that employers will need to carry out in order to comply with their new obligations. These can be categorised as four discrete processes:

- preparing for start-up: including setting up internal infrastructure, IT systems and adjusting payroll mechanisms;
- registration and qualification: including training staff;
- employee enrolment: including registering employees with the qualifying scheme; and
- collection and administration: including the monthly process of collecting contributions and making adjustments to payslips, etc.

G.9 Each of the processes described above involves a number of tasks which the firm will need to carry out. The cost of each task is dependent upon:

- the time taken to carry out the task;
- the person carrying out the task and their hourly wage; and
- the number of workers in the firm who would be enrolled into a qualifying scheme.

G.10 The estimates for qualifying schemes are derived from the four original processes and use the same Standard Cost Model methodology. The tables in Appendix 1 to this Annex provide details on the costs of each of these processes by firm size.

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<sup>181</sup> *Anticipated administrative costs on businesses of proposed personal accounts arrangements - Focus group study on the monthly administration of the collection of contributions*, Durham Business School, forthcoming.

<sup>182</sup> Forthcoming: *Enquiry on the anticipated administrative costs of additional payroll services to support personal account arrangements*, Middlesex University, forthcoming.

## New administrative cost estimates

G.11 Table G.2 sets out our latest estimates of the administrative costs to firms of automatic enrolment and contribution collection by firm size. The estimated total cost to employers is around one-fifth higher in the first year of introduction (£350 million) and 5 per cent higher in future years (£101 million)<sup>183</sup> compared to the estimates presented in the December 2006 Regulatory Impact Assessment.

<b>Table G.2: Total additional administrative and compliance costs to all firms of running either personal accounts or an alternative qualifying scheme<sup>184</sup></b>		
	Cost in Year 1 (£ million)	Ongoing annual cost in future years (£ million)
Large firms	37	6
Medium firms	34	6
Small firms	105	28
Micro firms	167	59
Single person director firms (firms with no employees)	8	2
<b>Total costs</b>	<b>350</b>	<b>101</b>

Source: DWP modelling.

Note: Costs are expressed in 2007/08 prices.

## Summary of changes to administrative cost estimates

G.12 Although our latest estimates appear to be broadly similar to those presented in the December 2006 Regulatory Impact Assessment, there are a number of differences in the way we have estimated the different processes that employers might be expected to perform. This is set out in Table G.3.

<sup>183</sup> This figure is different to the £93m ongoing administrative burden stated on the summary page because the £101m is the administrative cost to employers in 2007/08 rather than 2005 terms.

<sup>184</sup> The cost of each employer registering with TPR is included in these cost estimates. A small number of compliant employers may have further dealings with the compliance body, for example if they are selected for investigation on the basis of a risk profile determined by employer characteristics. This additional contact is not included in our admin cost estimates because it is not clear how many compliant employers will be affected and so we don't yet have a sufficiently robust cost estimate.

<b>Table G.3: Impact of methodological changes on estimates of the total employer administrative costs</b>		
	Costs in Year 1 (£ million)	Ongoing annual costs in future years (£ million)
<b>Total cost increase</b>	<b>59</b>	<b>5</b>
<b><u>This is due to...</u></b>		
Inclusion of single person director firms	8	2
Change in our estimate of time spent on training	-14	-9
Change in our estimate of the cost of administering monthly contributions	2	2
Change in our estimate of the cost of outsourcing	3	3
Inclusion of the opportunity cost of the time employees spend on pensions related activities whilst at work	16	1
Inclusion of time for employers to decide on how they will choose to fulfil their employer duty	18	0
Inclusion of time for employers to communicate changes to staff	14	0
Number of non-eligible employees revised	-18	-5
Qualifying schemes excluded from personal accounts cost	-65	-13
Qualifying schemes included as separate cost	50	12
Inclusion of registration activity in place of self certification	6	0
Change in the employee opt out rate	<1	<1
Changes to the wage estimate and inclusion of non-wage costs	39	12

Source: DWP modelling 2007/08 prices. Figures may not sum due to rounding.

## Single person director firms

G.13 Our latest estimates include the costs that could be borne by single person director firms. In these firms, the owner/manager is the sole employee. The Inter-Departmental Business Register suggests that around 250,000 of these firms might need to comply with the new employer duty. As the employer is also the sole employee in such firms, we have only included those activities up to the point where the director either opts in or decides to seek exclusion, as after this point they are considered employees.

## Wages

G.14 This analysis is based on median wage estimates from the Annual Survey of Hours and Earnings 2006, which have been updated to 2007/08 earnings terms. Wages have been inflated by 30 per cent to take account of non-wage costs, such as employer national insurance contributions, estate costs and IT costs. We have incorporated new analysis on dividend payments in the smallest firms to more accurately reflect the remuneration of the owner/manager in these firms.

## Training and learning

G.15 We have revised our estimate on the amount of training and learning required to take into account both employee and employer churn in future years.

## Monthly collection

G.16 Firms will incur different costs depending on whether they administer their payroll functions internally or outsource this obligation to a third party supplier. In our previous estimates, we assumed that per employee costs of outsourcing were equivalent to the costs of a large firm. Our analysis has since been refined such that the costs to firms which outsource their payroll functions are estimated separately to firms which administer their payroll internally.

## *In-house payroll*

G.17 We have used HMRC analysis<sup>185</sup> to update our estimates of the time taken to fulfil employer duties. To ensure the validity of our estimate, researchers from Durham Business School<sup>186</sup> were commissioned to run a number of focus groups made up of employers to consider the time taken to carry out the monthly collection process for firms of different sizes. The research reported that the majority of respondents thought our estimates were appropriate if not a little high.

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<sup>185</sup> <http://www.hmrc.gov.uk/better-regulation/kpmg.htm>

<sup>186</sup> Durham Business School, forthcoming: *Anticipated administrative costs on businesses of proposed personal accounts arrangements - Focus group study on the monthly administration of the collection of contributions*

### ***Outsourced payroll***

G.18 We have refined our estimates to reflect HMRC information on the proportion of employers who are likely to outsource their monthly payroll obligations. Middlesex University<sup>187</sup> was commissioned to examine the costs of additional obligations arising from personal accounts requirements for firms who outsource their payroll systems. The results of their telephone survey suggest that additional costs to employers that already outsource their existing payroll obligations would be minimal due to the automated nature of the processes.

### **Opportunity cost of employees' time**

G.19 We have included an estimate of the opportunity costs of employees' time whilst they conduct pension related activity in the workplace, for example reading relevant HR guidance distributed to them.

### **Decision making**

G.20 An additional activity has been included to account for the time employers might spend deciding how to respond to their new employer duty. This is voluntary and considered a one-off implementation cost.

### **HR guidance**

G.21 The revised estimates include time spent writing and providing HR advice around what the pension reforms mean for a firm's employees. This is a voluntary activity which some employers may choose to do.

### **Employer registration**

G.22 Our analysis has been refined in light of our more developed thinking on the compliance regime that will accompany automatic enrolment. More specifically, the new requirement for all employers to register with the Pensions Regulator.

### **Employer choice and employee opt out**

G.23 Our estimates have been updated to take account of the latest estimates of the number of people saving after reform and where they might be saving, as set out in Chapter 2.

### **Qualifying schemes costs**

G.24 As discussed above, we have included the costs to employers who choose to use a qualifying scheme instead of personal accounts to fulfil their employer duty.

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<sup>187</sup> Middlesex University, forthcoming: *Enquiry on the anticipated administrative costs of additional payroll services to support personal accounts arrangements..*

## Costs to employers according to how they fulfil their new duties

G.25 Total administrative cost to firms that are likely to use existing schemes to fulfil their automatic enrolment duties is lower than the estimated cost to firms that are likely to use personal accounts. This is illustrated in Table G.4. This is because the vast majority of firms that choose to use a qualifying scheme are likely to already have a scheme in place and as such avoid the costs of setting up new systems.

G.26 It is assumed that for an employer not currently involved in pension provision, there is little difference between the minimum administrative costs of setting up and operating personal accounts compared to setting up an alternative qualifying scheme.

<b>Table G.4: Employer costs, broken down by those using personal accounts and other qualifying schemes (£ million)</b>				
	Personal accounts		Qualifying schemes	
	Costs in Year 1	Ongoing costs in future years	Costs in Year 1	Ongoing costs in future years
Large firms	25	4	12	2
Medium firms	25	4	10	2
Small firms	89	24	15	4
Micro firms	154	55	13	4
Single person director firms	8	2	0	0
<b>Total costs</b>	<b>300</b>	<b>89</b>	<b>50</b>	<b>12</b>

Source: DWP modelling

- Figures are expressed in 2007/08 prices;
- Figures are rounded to the nearest £100, where the figure is less than £100 it is rounded to the nearest £10;
- Figures may not sum due to rounding.

### Average costs per firm

G.27 Tables G.5 and G.6 show the average administrative cost faced by firms using personal accounts and existing qualifying schemes to fulfil their employer duties.

G.28 As explained above, firms using an existing scheme are likely to face lower additional costs relative to firms using personal accounts. This is because firms with an existing pension scheme are likely to have to enrol fewer additional

workers, for a given firm size. Such firms will also have the advantage of having the necessary systems and processes already in place and knowledge of what providing a pension involves.

**Table G.5: Average administrative cost by firm size for a firm offering personal accounts**

	Number of firms	Cost in Year 1 (£)	Ongoing cost in future years (£)
Large firms	2,400	10,400	1,800
Medium firms	13,000	1,900	300
Small firms	271,000	300	90
Micro firms	680,000	200	80
Single person director firms	254,000	30	10
<b>Average costs for all firms (excluding single person director firms)</b>	<b>966,000</b>	<b>300</b>	<b>90</b>

Source: DWP modelling

Notes:

- Figures are expressed in 2007/08 prices;
- Figures are rounded to the nearest £100, where the figure is less than £100 it is rounded to the nearest £10;
- Figures may not sum due to rounding.

**Table G.6: Average employer administrative cost for a firm offering a qualifying scheme**

	Number of firms	Cost in Year 1 (£)	Ongoing cost in future years (£)
Large firms	4,000	3,400	600
Medium firms	14,000	700	100
Small firms	100,000	200	40
Micro firms	120,000	100	40
<b>Average costs for all firms</b>	<b>238,000</b>	<b>200</b>	<b>50</b>

Source: DWP modelling

Notes:

- Figures are expressed in 2007/08 prices;
- Figures are rounded to the nearest £100, where the figure is less than £100 it is rounded to the nearest £10;
- Figures may not sum due to rounding.

G.29 Tables G.5, G.6 and G.7 show that while the average per firm cost is greatest for the largest firms, per employee costs are estimated to be much smaller. This reflects the fact that most small firms do not already provide a pension with an employer contribution and so will need to enrol a larger proportion of their workforce into a pension scheme. The greater scale of large firms also allows them to spread the fixed costs associated with these reforms across a larger number of employees, as well as benefiting from economies of scale.

**Table G.7: Employer administrative cost per employee by firm size (£)**

	Cost in Year 1	Ongoing cost in future years
Large firms	10	2
Medium firms	30	4
Small firms	40	10
Micro firms	150	50
Single person director firms	40	10

Source: DWP modelling

Notes:

- Figures are expressed in 2007/08 prices;
- Other figures are rounded to the nearest £100, where the figure is less than £100 it is rounded to the nearest £10;
- Figures may not sum due to rounding.

## Implementing the reforms

G.30 Through the work of the expert group the Government has developed a more thorough understanding of the processes that employers will need to carry out in order to comply with their new responsibilities. This will be used to influence the design and implementation of the personal accounts scheme in line with the Delivery Authority's objective to minimise burdens on employers. Key lessons learned include:

- processes should be made as simple as possible for employers;
- automation and the use of software should be encouraged to reduce costs;
- the focus group responses showed that employers were supportive of the tools supplied by HMRC to help employers complete their tax returns and suggested that something similar should be produced for their new employer duty;
- employers suggested that the Personal Accounts Delivery Authority should seek to learn from the experiences of HMRC in communicating changes to employers and look to incorporate examples of good practice;



- in many single person director firms, the owner is also the sole employee. We are considering options for a simple exemption mechanism in order to reduce employer burdens for these firms; and
- administering monthly contributions is the most costly ongoing activity for employers and so reducing the amount of information required from the employer on a monthly basis would reduce these costs significantly.

**Appendix 1: Employer administrative costs by process and firm size**

<b>Table G.8: Employer administrative costs in Year 1 by process and firm size (£ million)</b>						
	Firms operating personal accounts				Firms operating an alternative qualifying scheme	
	Preparing for start-up	Registration and training	Enrolment of eligible workers	Collection and administration	Firms using existing schemes	Firms setting up new schemes
Large firms	9	2	11	3	12	0
Medium firms	11	5	4	4	10	0
Small firms	26	32	8	23	13	2
Micro firms	33	61	7	53	7	6
Single person director firms (firms with no employees)	0	8	0	0	0	0
<b>Total costs</b>	<b>79</b>	<b>108</b>	<b>30</b>	<b>82</b>	<b>42</b>	<b>8</b>

Source: DWP modelling

Note: Costs are expressed in 2007/08 prices

<b>Table G.9: Annual employer administrative costs in future years by process and firm size (£ million)</b>						
	Firms operating personal accounts				Firms operating an alternative qualifying scheme	
	Preparing for start-up	Registration and training	Enrolment of eligible workers	Collection and administration	Firms using existing schemes	Firms setting up new schemes
Large firms	0	0	1	3	2	0
Medium firms	0	0	0	4	2	0
Small firms	0	0	1	23	3	1
Micro firms	0	1	1	53	2	3
Single person director firms (firms with no employees)	0	2	0	0	0	0
<b>Total costs</b>	<b>0</b>	<b>3</b>	<b>3</b>	<b>83</b>	<b>8</b>	<b>4</b>

Source: DWP modelling

Note: Costs are expressed in 2007/08 prices

# Annex H: Estimates of the costs and benefits – assumptions and methodology

H.1 Details of the methodology and assumptions underpinning our estimates of the numbers of savers and employer administrative costs are contained in Annex F and G respectively. This Annex provides an explanation of the additional assumptions and methodology used to calculate the costs and benefits of the measures being introduced in the Bill.

## Assumptions

H.2 The assumptions underpinning our analysis are consistent with HM Treasury's economic assumptions. These were used in the Budget 2007 Financial Statement and the Budget Report. Apart from this, the main assumptions are as follows:

### Population projections

H.3 The demographic projections used are based on data produced by the Population Division of the Office for National Statistics (ONS) and by the Government Actuary's department (GAD).

H.4 We have based our estimates on the latest (2006-based) population projections for the United Kingdom and constituent countries, published in September 2007.

### Inflation

H.5 The Bank of England is assumed to meet its 2 per cent inflation target for the Consumer Prices Index (CPI) on average. All other inflation assumptions (such as the Retail Price Index) are determined relative to this CPI baseline, with differences reflecting the different coverage and methodology behind the different measures.

H.6 House prices are assumed to rise in the long term in line with earnings.

### Productivity and earnings growth

H.7 Productivity is assumed to increase at 2 per cent per year over the medium term. It is assumed that real earnings growth follows productivity growth. Thus, it is implicitly assumed that there is no change in the labour share of overall GDP. Real GDP growth is the combination of employment and productivity growth.

## Methodology

### Modelling of outcomes for individuals

H.8 Since the publication of the Regulatory Impact Assessment for the 2007 Pensions Act, the DWP has updated its modelling of hypothetical individuals, which we use to estimate future income in retirement and replacement rates. This will mean some of the figures (in particular in tables 2.4 and 2.15) will not be comparable with those published in the December 2006 Regulatory Impact Assessment.

H.9 Updates to the modelling included in this publication include:

- Incorporation of policy changes announced in the Budget and Pre-Budget Report, in particular changes to National Insurance thresholds;
- improved private pension modelling, including developments to the annuity rate calculations and a movement to a lifestyling approach for modelling fund growth; and
- Incorporating new projections of life expectancy.

H.10 The results are, of course, illustrative and dependent on assumptions about factors such as investment growth.

### Estimates of future pensioner incomes using Pensim2

H.11 Pensim2 is a dynamic micro-simulation model that has been developed in DWP to inform analysis of likely future trends in pensioner incomes. Pensim2 builds up a picture of the future pensioner population by modelling future life events and work histories for a representative sample of individuals.

H.12 The model currently starts from a set of base data representative of the GB household population in 2001. This base data includes detailed information on the characteristics of individuals and their employment and pension histories to date. For each subsequent year, sets of equations are used to model, for each individual, the probability of certain events occurring, based on estimates from current data. The calculated probabilities are then used within the model to determine what happens to each individual in a given year.

H.13 The individual labour market and pension histories generated by the model are used to calculate estimates of pensioner incomes in each year of the simulation.

H.14 The methodology and equations underlying Pensim2 were validated by the Institute for Fiscal Studies. Their findings and recommendations for further development were published in a working paper in 2004. This is available on their

website<sup>188</sup>. Results from Pensim2 have been validated by comparing a range of key outputs against trends in recent administrative and survey data and the projections produced using other modelling approaches.

H.15 Pensim2 is particularly well-suited to long-term projections of expenditure on income-related benefits, where the distribution of future pensioner incomes is a key determinant of entitlement and expenditure. Pensim2 models the future accrual of pensions by individuals, based on their projected labour market status each year.

H.16 All models are constantly reviewed and refined. The latest version of Pensim2, which was used to generate the analysis contained in this document, has been improved since publication of the Regulatory Impact Assessments for the Pensions Bill 2006 and the December 2006 White Paper. Major developments include improvements in modelling of the labour market; accounting for the latest population projections from the Government Actuary's Department and revising behavioural assumptions using recent DWP research evidence<sup>189</sup>.

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<sup>188</sup> Published on the DWP website at:

[www.dwp.gov.uk/pensionsreform/forum/docs/fs-pc-projection.pdf](http://www.dwp.gov.uk/pensionsreform/forum/docs/fs-pc-projection.pdf)

<sup>189</sup> DWP survey of employer attitudes: research by BMRB for DWP (Grant C, Fitzpatrick A, Sinclair P and Donovan JL, forthcoming in 2008, *Employers' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*) and DWP survey of individual attitudes: research by Ipsos MORI for DWP (Smith P, Webb C, Pye J, Robey R, and Jeans D, forthcoming in 2008, *Individuals' attitudes and likely reactions to the personal account reforms 2007: Report of a quantitative survey*).



## Annex I: Glossary

Active members	Active members are current employees who are contributing (or having contributions made on their behalf) to an organisation's <b>occupational pension</b> scheme. The scheme may be open or closed.
Additional Pension (AP)	The earnings-related state pension paid in addition to the <b>Basic State Pension</b> . From 1978-2002 it accrued under the <b>State Earnings Related Pension Scheme (SERPS)</b> and from 2002 under the <b>State Second Pension (S2P)</b> scheme.
Annual management charge (AMC)	The charge generally applied to personal pension plans where the fee is levied as an annual charge on the value of the fund. This charge covers the sales, administration and fund management costs of the fund.
Annuity	Purchased with an individual pension fund, which has been built up in a <b>defined contribution pension scheme</b> , to provide a pension that is usually payable for life. A single-life annuity pays benefits to an individual. A joint-life/survivors annuity pays benefits to the spouse/dependent partner after death of the first. A level annuity pays constant payments whereas an index-linked annuity pays benefits relating to an index (for example the <b>Retail Prices Index</b> ).
Automatic enrolment	A system whereby an individual is made a member of a pension scheme unless they actively opt out of the scheme.
Basic State Pension (BSP)	An amount of money payable to those who are entitled to it (who have reached State Pension age and claimed it) that is based on the amount of National Insurance contributions a person has paid, has been treated as having paid or has been credited with.
Bond	A debt investment in which the investor loans money to an entity (company or government) that borrows the funds for a defined period of time at a specified interest rate.
Contracting out	The system by which individuals can choose to opt out of <b>State Second Pension</b> and use a proportion of their <b>National Insurance Contribution</b> to build up a <b>funded</b> pension. There are four types of schemes, into which an individual may contract out of. The rules and rebate levels are different for each. These are: <b>contracted-out salary related scheme, contracted-out mixed benefit scheme, contracted-out money purchase scheme</b> and <b>approved personal pension</b> .
Decumulation	The drawing down of pension assets to fund retirement. In the UK, it is permitted to access pension assets partially as a tax-free lump sum and partially as an income stream (i.e. annuity or income draw down).
Default fund	In defined contribution pension schemes, some members do not make a choice of investment fund. These members will have their contributions paid into a default fund, designated for that purpose.
Defined benefit (DB) pension scheme	A pension scheme where the pension is related to the members' salary or some other value fixed in advance.

Defined contribution (DC) pension scheme	A scheme where the individual receives a pension based on the contributions made and the investment return that they have produced. They are sometimes referred to as money purchase schemes.
Discount Rate	An interest rate used to reduce an amount of money at a date in the future to an equivalent value at the present date.
Equity	Share or any other security representing an ownership interest.
Funded pension scheme	Pension schemes in which pension contributions are paid into a fund which is invested and pensions are paid out of this fund.
Gross Domestic Product (GDP)	A measure of economic activity in a country. It is calculated by adding the total value of a country's annual output of goods and services.
Gross National Product (GNP)	A measure of economic activity. It is the value of all goods and services produced in a country in one year, plus income earned by its residents abroad, minus income payable to non-residents.
Guarantee Credit	A means-tested benefit which is part of Pension Credit and brings pensioners' income up to a guaranteed minimum level. In 2007/08 the standard minimum guarantee for a single person is £119.05 a week. For a couple the level is £181.70 a week. The guaranteed minimum is higher for some groups, such as disabled people, carers and people with certain housing costs who qualify for additional amounts.
Guaranteed Minimum Pension (GMP)	The minimum pension that must be provided by a <b>contracted-out</b> salary-related scheme for pensions accrued between 1978 and 1997. The GMP is roughly equivalent to the foregone <b>SERPS</b> from <b>contracting out</b> .
Her Majesty's Revenue and Customs (HMRC)	The department responsible for the business of the former Inland Revenue and HM Customs and Excise. It is the department responsible for <b>National Insurance</b> .
Income related benefits	State benefits where the amount paid depends on the level of income and capital and other personal circumstances.
Independent Financial Adviser (IFA)	Someone who is authorised to provide advice and sell a wide range of financial products. They are distinguished from tied financial advisers, who can only give advice on investment products offered by a specific company.
Job mobility	Job mobility refers to the movement of people between jobs with different employers.
Large firm	For statistical purposes, the Department for Business, Enterprise and Regulatory Reform usually defines a large firm as one with 250 or more employees.
Life expectancy	Life expectancy at a given age, $x$ , is the average number of years that a male or female aged $x$ will live thereafter, and is calculated using age- and gender-specific mortality rates at ages $x$ , $x+1$ , $x+2$ , etc.
Longevity	Length of life.
Longitudinal Study	A research study which follows a group of individuals over a period of time.



Median	The median of a distribution divides it into two halves. Therefore half the group are above the median value and half below.
Medium firm	For statistical purposes, the Department for Business, Enterprise and Regulatory Reform usually defines a medium firm as one with between 50 and 249 employees.
Micro firm	For statistical purposes, the Department for Business, Enterprise and Regulatory Reform usually defines a micro firm as one with between 1 and 4 employees.
National Insurance (NI)	The national system of benefits paid in specific situations, such as retirement, based on compulsory or voluntary contributions. There are four main classes of contributions.
Occupational pension.	A pension which is provided via the employer, but the pension scheme takes the form of a trust arrangement and is legally separate from the employer
Open Market Option (OMO)	The longstanding Government policy for money-purchase (defined contribution) pension arrangements that individuals may shop around for an annuity rather than remaining with the provider with whom they made their pension saving, since incorporated into tax legislation (Section 165 of the Finance Act 2004).
Pension accrual	The build up of pension rights. In a <b>Defined Benefit</b> scheme this may be based on the number of years of contributions.
Pension Credit	The main <b>income related benefit</b> for pensioners, which combines the <b>Guarantee Credit</b> and the <b>Savings Credit</b> .
pension credit	The share of a pension arrangement awarded to a former spouse on divorce
Pension Protection Fund (PPF)	Established in April 2005 to pay compensation to members of eligible defined benefit pension schemes, when there is a qualifying insolvency event in relation to the employer and where there are insufficient assets in the pension scheme to cover Pension Protection Fund levels of compensation.
The Pensions Commission	The Pensions Commission, chaired by Lord Adair Turner, was set up in 2002 to review the UK private pension system and long-term savings. The Pensions Commission has now concluded its review and been disbanded.
The Pensions Regulator (tPR)	The regulator of work-based pension schemes in the UK.
Pay As You Earn (PAYE)	A method of paying income tax. The taxpayer's employer deducts tax from their wages or occupational pension before paying these wages, and passes these contributions over to HMRC. In order to do this, the employer must have a PAYE scheme set up. Wages includes sick pay and maternity pay.
Persistence (in relation to saving)	Where someone continues to make contributions to a pension scheme over time.
Personal pension	A pension which is provided through a contract between an individual and the pension provider. The pension produced will be based on the level of contributions, investment growth and <b>annuity</b> rates. A personal pension can either be employer provided (a <b>Group Personal Pension</b> ) or purchased individually.

Price-indexed	Increasing each year in line with inflation.
Protected rights	The element of the <b>Defined Contribution</b> pension arising from <b>Contracted-out</b> rebates.
Rate of return	The gain or loss of an investment over a specified period, expressed as a percentage increase over the initial investment cost. Gains on investments are considered to be any income received from the asset, plus realised capital gains.
Real terms	Figures have been adjusted to remove the effect of increases in prices over time (i.e. inflation), usually measured by the <b>Retail Prices Index</b> . Thus if something shown in real terms increases then it is rising faster than prices, whereas if it is constant, it rises at exactly the same pace as prices.
Reference Scheme Test (RST)	A test of overall pension scheme quality currently used for defined benefit schemes that are contracted-out of the State Second Pension. A scheme satisfies the test if the pensions provided to at least 90 per cent of the members are broadly equivalent to, or better than, the pension which would be provided under the Reference Scheme which: is payable from age 65; is paid for life; accrues for each year of pensionable service (40 years maximum) at the rate of one-eightieth of average qualifying earnings in the last three years of service; is based on qualifying earnings defined as 90 per cent of earnings between the Lower Earnings Limit and the Upper Earnings Limit; and provides a 50 per cent survivor benefit for a spouse or civil partner.
Replacement Rate	Measures income in retirement as a percentage of income before retirement.
Retail Prices Index (RPI)	This is an average measure of the change in the prices of goods and services bought for consumption by the vast majority of households in the UK.
Savings Credit	Part of the <b>Pension Credit</b> . It is a <b>means-tested benefit</b> for people aged 65 or over, which accrues at the rate of 60p for each £ of income above a threshold (currently set at £87.30 for a single person and £139.60 for a couple) up to a maximum amount (£19.05 for a single person, £25.26 for a couple).
Small and Medium-Sized Enterprise (SME)	For statistical purposes, the Department for Business, Enterprise and Regulatory Reform usually defines a SME as a firm with 249 or fewer employees.
Small firm	For statistical purposes, the Department for Business, Enterprise and Regulatory Reform usually defines a small firm as one with 49 or fewer employees.
Stakeholder pension	A personal pension product which complies with regulations which limit charges and allow individuals flexibility about contributions.
Stakeholder charge cap	A 1.5 per cent annual management charge (AMC) for cap the first ten years of the policy, and thereafter a 1 per cent AMC.

Standard minimum guarantee	The minimum level of income guaranteed to pensioners through the <b>Guarantee Credit</b> element of <b>Pension Credit</b> . (The guaranteed level for some groups of pensioners, such as severely disabled people, carers and people with certain housing costs who qualify for additional amounts, is higher than the standard minimum guarantee.)
State Earnings Related Pension Scheme (SERPS)	The forerunner of the <b>State Second Pension</b> , which provides an earnings-related <b>National Insurance</b> pension based on contributions.
State Pension age (SPA)	The minimum age at which a person can claim their State Pension. It is currently 65 for men and 60 for women born before 6 April 1950. For women born on or after 6 April 1950 and before 6 April 1959 State Pension age will gradually increase to 65 between 2010 and 2020. The State Pension age will further increase for both men and women from 65 to 68, between 2024 and 2026. This further increase will affect anyone born on or after 6 April 1959.
State Second Pension (S2P)	The earnings-related National Insurance pension paid in addition to basic State Pension – gives a more generous pension than would have been provided by SERPS for: low and moderate earners; carers who are looking after young children or a disabled person; and long-term disabled people.  The 2007 Pensions Act introduced a simpler S2P from 2012. This Pensions Bill proposes to wrap up the complex accrual structures of GRAD, SERPS and pre-2012 S2P into a consolidated cash amount for persons retiring from 2020.
Tax credits	There are two main types of tax credit. Working Tax Credit is an income related credit for working adults and Child Tax Credit is an income-related credit payable to families with responsibility for children, whether they are in or out of work.
Tax-free lump sum	Twenty-five per cent of pension saving may be taken as a tax-free lump sum. This 25 per cent may include protected rights but not the Guaranteed Minimum Pension.
Tax relief	Individuals making contributions to tax approved pension schemes receive tax relief at their <b>marginal tax rate</b> (e.g. a standard rate taxpayer will receive tax relief at 22 per cent). Individuals contributing to <b>stakeholder pensions</b> receive tax relief at a minimal rate of 22 per cent. Individuals with very low or no tax liabilities can also receive “tax relief” at 22 per cent on contributions of up to £2,808 per year. Employers’ contributions are made from gross profits and thus are both tax and <b>National Insurance</b> privileged.
Trivial commutation	If an individual’s total pension accumulation is less than 1 per cent of the lifetime limit on tax relievable pension saving (£15,000 on 2006/07) then individuals are not required to annuitise their fund and can instead take it as a taxable lump sum.
Unfunded pension scheme	Pension schemes that are not backed by a pension fund. Instead, current contributions are used to pay current pensions along with other funds provided by the employer.

Vertical integration	In microeconomics the term vertical integration describes a style of ownership and control. The degree to which a firm owns its suppliers and buyers determines how vertically integrated it is. It is typified by one firm engaged in different aspects of production.
Working age population	Generally those aged 16 and over but below State Pension age (currently defined as women aged 16-59 and men aged 16-64).
Workplace personal pension arrangements	A workplace personal pension arrangement refers to any personal pension, or collection of personal pensions, to which the employer makes a contribution. This includes group personal pensions and group stakeholder pensions. The contractual agreement in such arrangements lies between the provider and the individual. The employer is not part of the contractual agreement but often facilitates such arrangements for their workers (for example by giving workers access to the scheme, making payroll deductions, etc.).