

People benefiting from private pension reform: explanation of participation estimates

Summary

The 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. The private pension reforms include automatic enrolment into workplace pension schemes, a compulsory minimum employer contribution and the introduction of a low cost personal accounts pension scheme targeted at those not served by the existing market.

There is inherent uncertainty in trying to make any estimate of the precise impact of these reforms so far in advance of their introduction. This factsheet sets out our current working assumption of the number of people who will be brought into saving through these reforms. This is based on the latest information and research available on possible trends in pension provision, labour market patterns and the likely reactions of employers and individuals to the private pensions reforms.

These working assumptions indicate that around 9–11 million workers will be eligible for automatic enrolment in a workplace pension scheme in 2012. This will lead to 6–9 million workers saving more in workplace pensions, because they are either newly participating or saving more than they would otherwise have.

Employers will be able to choose between enrolling all eligible jobholders into either an employer-sponsored pension scheme or into the new personal account scheme. We estimate that there will be 4–7 million individuals participating in personal accounts. And that overall there will be about 1–2 million additional people saving or saving more in existing pension schemes.

The Government will continue to monitor trends within the pensions landscape, the economic context in which these reforms will be introduced, and the likely responses of individuals and employers to these reforms. As we move towards 2012, we will continue to update these estimates in the light of new evidence.

Introduction

This factsheet presents analysis on the impact of the introduction of automatic enrolment, minimum employer contributions and the new personal accounts scheme, on the number of people saving in a workplace pension scheme. It sets out how this analysis has evolved since that presented in the May and December 2006 Regulatory Impact Assessments.¹

From 2012, workers between the age of 22 and State Pension age, with annual earnings in at least one job of more than £5,035 (2006/07 earnings terms) will be eligible for

¹ *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

automatic enrolment into a qualifying pension scheme, unless they are already participating in such a scheme.² It will be for the employer to choose the qualifying scheme into which they enrol their workers. The new personal accounts scheme will be one option open to employers. It is being set up to target those employers who do not currently have a pension scheme. Employer-sponsored pension schemes will qualify by meeting one of two tests³.

This factsheet sets out our best estimates at this point in time – they are working assumptions. There is inherent uncertainty around these figures in relation to: trends in pension provision between now and 2012, ongoing policy development and uncertainty over likely employer and individual behaviour in response to these reforms. This is why these figures are generally presented as broad ranges. We also plan to continue to monitor trends in pension provision and in likely behaviour to continue to understand how this will affect employers, individuals and the financial services industry. As we move towards 2012, and as we get more information, we will continue to update these figures.

These working assumptions reflect updated figures on pension provision and population projections, new evidence on likely behaviour from surveys of individuals and employers and have been updated in the light of policy developments.

Estimate of pension participation following the reforms

Figure 1 below sets out the range and central working assumptions of numbers of people eligible for automatic enrolment and likely numbers of people participating in personal accounts and existing pension schemes in 2012. This factsheet sets out how these estimates were derived.

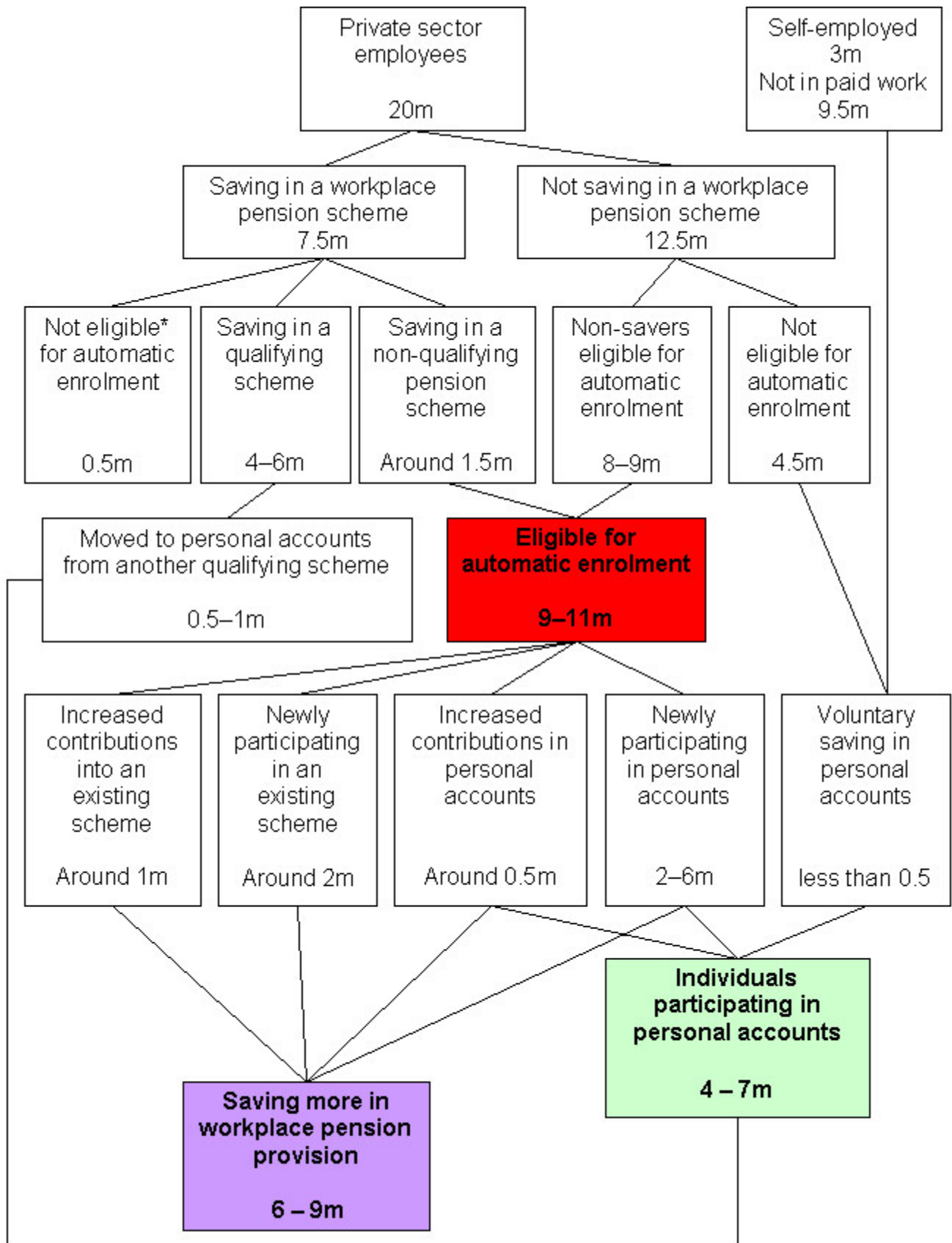
The working assumption for 2012 is based on projecting pension participation forward between now and 2012 taking into account trends in pension provision seen in recent years and new population projections. To reflect uncertainty about trends between now and 2012 we have ranges based on different scenarios for pension provision.⁴

² Employers will have to start enrolling eligible jobholders from the start of 2012. The leading option is that this will be by employer size, with the largest employers first. The working assumption used here is that all eligible jobholders will be enrolled within the first operational year.

³ A key element of the test for money purchase schemes will be an employer contribution of at least 3 per cent of the worker's earnings that fall within a band of earnings (between £5,035 and £33,500 in 2006/7 earnings terms). Defined Benefit schemes contracted out of State Second Pension which pass the reference scheme test (RST) will qualify to be used for automatic enrolment. Contracted-in schemes and formerly contracted-out schemes which provide a minimum accrual of 1/120th (on each year's pensionable service) based on simplified principles of RST will qualify to be used for automatic enrolment.

⁴ In the constant pensions scenario we assume that the decline in Defined Benefit schemes is offset by an increase in other forms of pension provision. In the declining pensions scenario we assume that the decline in Defined Benefit schemes is not offset by the growth in other provision, and in the growing pensions scenarios we assume that there is no further decline in Defined Benefit schemes and a continued growth of other forms of provision.

Figure 1: Working assumption on pension participation in 2012 (millions)



Source: DWP modelling

Notes: Numbers are rounded to 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)

Number of people eligible for automatic enrolment

The aim of automatic enrolment and the minimum employer contribution is to increase the number of people who are saving for retirement. Our working assumption is that between 9 and 11 million workers will be eligible for automatic enrolment in 2012. This total includes more than 1 million workers who are currently saving in schemes with less than a 3 per cent employer contribution. This compares to the estimates in the May and December 2006 Regulatory Impact Assessments of 10.1 million workers automatically enrolled into personal accounts and 0.7 million workers into existing pension provision.

Employer choice

Employers will be able to choose where to enrol their workers. Some may extend membership of existing schemes to more workers or set up their own pension schemes, others may choose to enrol some, or all of, their workers into the new personal accounts scheme.

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, and that employers who offer an employer contribution of less than 3 per cent would enrol all eligible workers into personal accounts. We also assumed that all those currently participating in schemes with more than 3 per cent contributions would continue to save in the existing scheme.

However, emerging findings from the forthcoming survey on employers' attitudes and likely reactions to the personal account reforms suggest that employers are more likely than we previously assumed to enrol non-members (including eligible workers who are currently not participating in the scheme) and new workers into existing schemes. In addition some employers who are currently not providing pensions have said that they will set up a new scheme to enrol workers. Most employers currently making contributions of 3% or more said they will maintain their current scheme for existing members. However, the survey suggests that a few employers may want to move some current members out of existing schemes into personal accounts. A summary of emerging findings from the survey provides further details of this research and how employers are likely to react to the reforms.⁵

Using the findings from the new employer survey we have updated our assumptions about the proportion of workers who would be enrolled (or remain in) existing pension schemes that become qualifying schemes. As there is a degree of uncertainty around how employers will react to the reforms in 2012, we have used three different assumptions: central, high and low to show the range of how employers and individuals could respond. 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 will be equivalent regardless of whether they are operating an occupational or personal pension scheme to fulfil the new duties.

⁵ Available at <http://www.dwp.gov.uk/pensionsreform/factsheets.asp>

Enrolment into existing schemes

Based on the new evidence from the employer survey, our working assumption is that between 2 and 3 million workers would be enrolled into existing pension schemes which meet the qualifying criteria (depending on both trends in pension provision and employer choice). Around 1 million workers who are currently 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 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.

Enrolment into personal accounts

Based on the new evidence from the employer survey our working assumption is that between 5 and 7 million workers who are not currently saving in a workplace pension scheme would be automatically enrolled into personal accounts. In addition, we assume that around 0.5 million workers who are currently participating in a pension scheme with less than 3 per cent contribution from the employer, and between 0.5 and 1 million workers⁶ currently participating in a scheme with more than 3 per cent employer contribution would be automatically enrolled into personal accounts.

In the May and December Regulatory Impact Assessments 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 a direct consequence of assuming, based on emerging survey evidence, that more employers would enrol workers into existing forms of pension provision.

Participation

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. The survey asked people whether they thought they would stay in or opt out of personal accounts. A summary of emerging findings from this survey provides further details of how individuals are likely to react to the reforms.⁷

This survey provides an update of our previous participation assumptions based on the characteristics of the target group. Based on this new evidence, taking account of the age distribution of those in the group eligible for automatic enrolment, and making assumptions about the behaviour of those who said 'probably' and 'don't know' or 'it depends', we estimate a central participation rate of around 75 per cent with a range between 55 and 80 per cent. We also assume that if someone is already saving in a pension scheme, they will continue to do so even if they are moved into personal accounts or have their contributions increased.

This participation rate is broadly similar, but a little higher, than that used in the May and December Regulatory Impact Assessments, which assumed that around a third of those enrolled would opt out. The previous assumptions on participation were drawn from a

⁶ 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

⁷ Available at <http://www.dwp.gov.uk/pensionsreform/factsheets.asp>

variety of different sources but were not directly based on the characteristics of those in the group eligible for automatic enrolment.

Applying these participation rates to those automatically enrolled into existing pension provision and personal accounts, leads to a working assumption of between 3 and 8 million workers participating in personal accounts. This is a very wide range and would require the most extreme outcome for all the key assumptions⁸ to simultaneously take place. We have carried out analysis to understand the likelihood of these extremes and have identified a narrower range of likely participation in personal accounts of 4–7 million people, based on a 99% confidence interval. We also estimate that around 1–2m additional workers will be saving or saving more in qualifying pension schemes.

Overall, our working assumption is that there will be between 6 and 9 million workers newly participating or 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, either in personal accounts or a qualifying scheme and 4–8 million people newly saving in personal accounts or an alternative qualifying scheme.

Other savers

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.

We estimate that in the long run⁹ around 10 per cent of the self-employed will participate in personal accounts, which is around 0.3 million people. This is revised from the 0.8 million estimate in the May and December Regulatory Impact Assessments.

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,¹⁰ we assume that 1 per cent of this group, or around 0.1 million, will participate in personal accounts. This is a reduction from the estimate of 0.7 million in the May and December Regulatory Impact Assessments. The previous estimate was higher as the requirement for a link to previous employment had not been clarified at that time.

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

⁸ In relation to pension trends, employer choice about where to enrol and individual participation rates.

⁹ The long run is assumed to be 10-15 years after implementation

¹⁰ DWP modelling based on the Family Resources Survey 2005/06

outside the automatic enrolment group will opt in to personal accounts. This is also based on evidence about their current participation in private pension saving.¹¹

Taking account of all these groups, we estimate that there could be up to 0.6 million people who choose to opt-in to personal accounts in the long run. 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.

How many people saving in personal accounts?

Adding in these other savers into the number of people participating in personal accounts in 2012, does not significantly change the overall estimates of participation. Our working assumption is that there will be between 4 and 7 million individuals in personal accounts in 2012.

¹¹ DWP modelling based on the Annual Survey of Hours and Earnings 2005 and the Labour Force Survey 2005