PENSIONS POLICY INSTITUTE

PPI

How will automatic enrolment affect pension saving?

'How will automatic enrolment affect pension saving?' is sponsored by Legal & General. The PPI's research series on the implications of the introduction of Automatic Enrolment is also sponsored by the Association of British Insurers (ABI), the Defined Contribution Investment Forum, the Department for Work and Pensions (DWP), the Institute and Faculty of Actuaries, Prudential and The People's Pension.

The PPI is grateful for the support of the following research series sponsors:

Sponsorship has been given to help fund the research and does not imply agreement with, or support for, the analysis or findings from the project.

A Research Report by Daniela Silcock, Ciaran Ellis and Mel Duffield

Published by the Pensions Policy Institute

ISBN 978-1-906284-29-9
www.pensionspolicyinstitute.org.uk

How will automatic enrolment affect pension saving?

Executive summary

Automatic enrolment into workplace pension schemes has now (July 2014) reached its second stage, and employers with between 50 and 249 workers have three months from their staging date (between April 2014 and April 2015) to automatically enrol all of their eligible workers into a qualifying workplace pension scheme. Workers then have a month to opt out. The required level of contributions that employers and workers who do not opt out must jointly make into a pension scheme is being phased in from 2012 to reach 8% minimum total contributions on band earnings (£5,772 to £41,865 in 2014/15) by 2018.

At minimum levels, the 8% will be made up of 3% from the employer, 4% from the employee and 1% from the Government in the form of tax relief, though employers can choose to pay more than 3% and thereby reduce the amount that their employees are required to contribute. If the employer chooses to pay the entire 8% themselves, then employees who do not opt out are not required to make any contributions under automatic enrolment regulations, though their employer may still expect them to contribute.

Employers and employees may choose to respond to automatic enrolment in different ways

While employers are required to automatically enrol eligible workers into qualifying schemes and pay contributions on behalf of those who do not opt out, they can choose:

- Which type of scheme to enrol their workers into (as long as the scheme meets certain standards);
- Whether to contribute into employees' pension schemes at minimum required levels or above.

Eligible workers also have choices regarding how to respond to automatic enrolment, such as:

- Whether to opt out of their pension scheme after being automatically enrolled;
- Whether, if they remain in their scheme, to contribute at minimum required levels or above.

The choices that employers and employees make in response to automatic enrolment will affect the future numbers of people saving in pension schemes and the aggregate value of future workplace pension scheme assets (contributions plus investment growth over time).

The current opt-out rate from automatic enrolment is around 9-10% on average

The first stage of automatic enrolment, with employers of 250 workers or more, is now complete. This has allowed for some analysis of how larger employers and their workers are responding. The following trends in behaviour among larger employers, during the first stage of automatic enrolment have been identified:

- Employers with existing provision (offering access to a scheme and employer contributions) were less likely to offer minimum contribution levels for new, automatically enrolled, employees than those without existing provision who were offering access to a new scheme;
- Employers who did not offer pension provision prior to automatic enrolment were more likely to say they intended to pay the minimum required level of contributions.

The following trends in employee behaviour have been identified:
- 9-10% of workers have opted out on average;
- Older workers and women are more likely to opt out, on average, than other workers;
- Those opting out cited financial constraints as the main reason.

Factors other than the choices made by employers and workers, such as scheme charges or market factors (including the level of investment return on pension funds) may all influence the number of people saving in pension schemes and the aggregate value of workplace pension scheme assets.

The self-employed are excluded from the analysis as they are not eligible for automatic enrolment, though they are not prohibited from voluntarily joining a pension scheme and paying contributions. The take up of private pension saving by self-employed people has declined over the last decade and in 2011 only 34% of self-employed people were active members of a pension. Unless a significant proportion of self-employed people choose to join a pension scheme, pension saving may remain low among this group even after automatic enrolment.

Modelling the effects of employer and employee response

This report uses stylised scenarios to explore the possible effect that employer and employee responses could have on the numbers of people actively saving and total aggregate assets (contributions plus investment growth over time) in private sector workplace pension schemes. Though there is some evidence available on the responses to the policy by large employers and their workers, there is limited evidence on how medium to smaller employers and their workers may respond or how all workers may respond once minimum employee contributions reach their full level of 4% (5% including tax relief). Therefore the scenarios in this report illustrate the potential impact of a range of scenarios rather than implying that any scenario is likely, or more likely, to occur.

Employee response

This report explores how different opt-out rates by workers (continuing until 2030 and including both those newly enrolled and automatically re-enrolled) might affect the number of people saving and the value of aggregate assets (contributions net of investment returns and charges) in private sector workplace pension schemes. The following scenarios are explored:
- **The "no automatic enrolment" scenario** – a baseline scenario which explores the impact of not introducing automatic enrolment

- **The "central opt-out rate" scenario** - a scenario which explores the impact of a 15% opt-out rate
- **The "low opt-out rate" scenario** - a scenario which explores the impact of a 9% opt-out rate
- **The "high opt-out rate" scenario** - a scenario which explores the impact of a 25% opt-out rate

A summary of the results of the analysis is shown below (Table A).

Table A: Effect on scheme membership and value of assets in private sector workplace pension schemes in 2030 based on different opt out scenarios (2014 earnings terms)

Scenario	Total private sector scheme membership	Private sector DC scheme membership	Private sector workplace pension scheme assets (DB &DC)	Private sector DC workplace pension scheme assets
No automatic enrolment	6.5 million	6 million	£1,050 billion	£350 billion
25% opt out	13 million	12.5 million	£1,160 billion	£455 billion
15% opt out	14 million	14 million	£1,180 billion	£480 billion
9% opt out	15 million	14.5 million	£1,200 billion	£495 billion

Scheme members (DB & DC)

- **By 2030** between 6.5 and 8.5 million people could be newly saving in a private sector workplace pension scheme
- **By 2030** between 13 and 14.5 million people in total could be saving in a private sector workplace pension scheme
- Assuming a 15% opt-out rate, 57% of private sector savers could be members of automatic enrolment multi-employer schemes in 2018.

DC scheme members

- **By 2018** the number of people saving in private sector DC workplace pension schemes could range between 12 and 13.5 million
- **By 2030** the number of people saving in private sector DC workplace pension schemes could range between 12.5 and 14.5 million

Total assets (DB & DC)

- **By 2030** the value of assets in private sector workplace pension schemes could range between £1,160 billion and £1,200 billion (2014 earnings terms)

DC assets

- **By 2018** The value of assets in private sector DC workplace pension schemes could range between £340 billion and £345 billion
- **By 2030** The value of assets in private sector DC workplace pension schemes could range between £455 billion and £495 billion (2014 earnings terms) (Chart A and B)

Chart A[1]

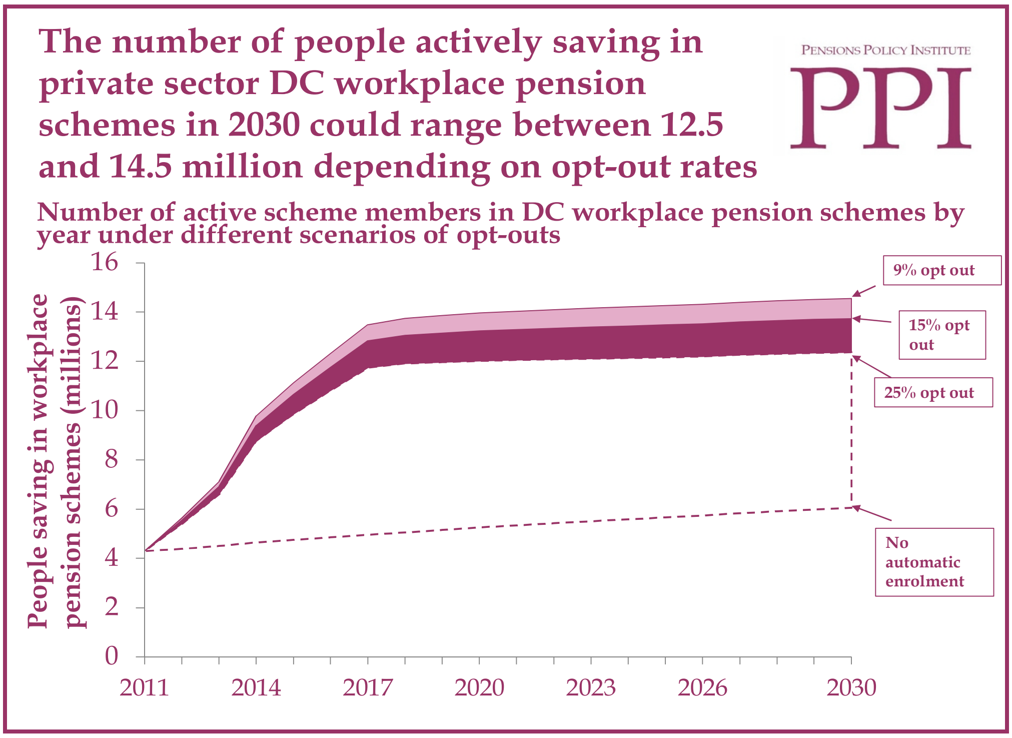
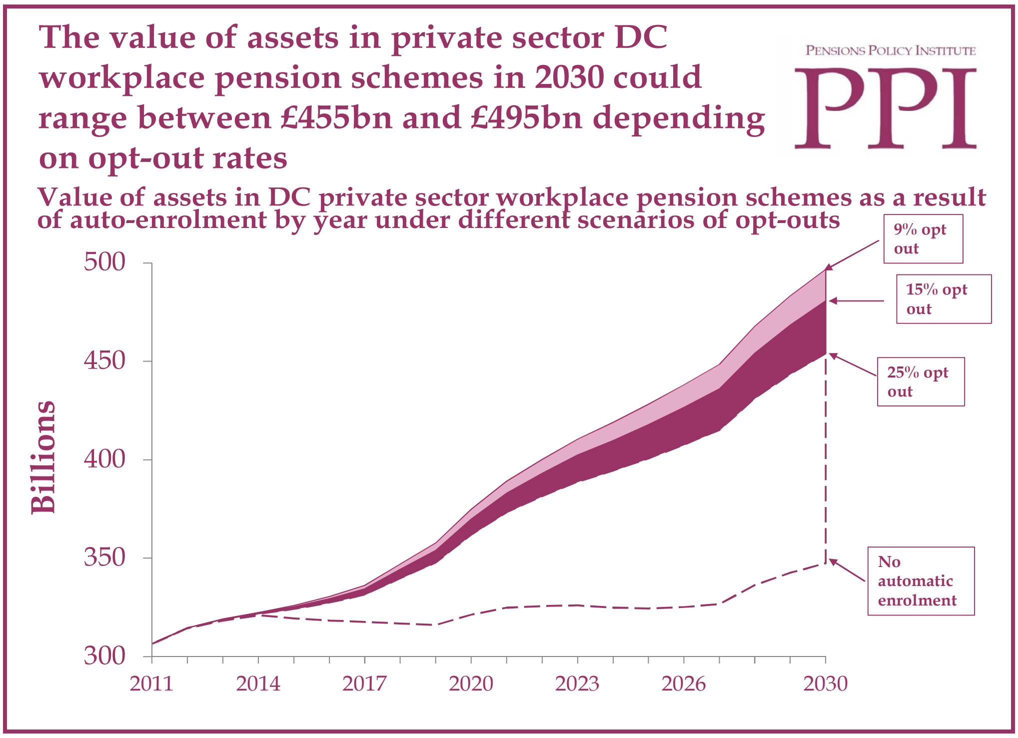


Chart B[2]



[1] PPI Aggregate Model
[2] PPI Aggregate Model

Employer response

This report uses scenario analysis to explore how different employer responses to automatic enrolment could affect the number of people saving into workplace pension schemes and the total value of private sector workplace pension assets. The following scenarios are explored:

- **The "minimum contributions" scenario –** a scenario which explores the impact of levelling down by all employers on behalf of all workers
- **The "existing trends" scenario –** a scenario which uses emerging data on the existing trends in employer behaviour to explore the impact of current behaviour or expectations continuing throughout the automatic enrolment process and in the future
- **The "maintaining current provision" scenario** - a scenario which explores the impact of maintaining current provision and contribution levels for the workers of all employers with existing provision

The analysis indicates that, assuming a wide range of employer responses to automatic enrolment and an average employee opt-out rate of 15%, the value of assets in DC private sector workplace pension schemes in 2030 could range between £450 billion and £505 billion (2014 earnings terms) (Table B, Chart C)

Table B: Effect on value of assets in private sector workplace pension schemes in 2030 based on a reasonable range of employer responses to automatic enrolment and an average employee opt-out rate of 15% (2014 earnings terms)

Scenario	Private sector workplace pension scheme assets (DB & DC)	Private sector DC workplace pension scheme assets
Minimum contributions	£1,160 billion	£450 billion
Existing trends	£1,180 billion	£480 billion
Maintain current provision	£1,210 billion	£505 billion

Chart C[3]

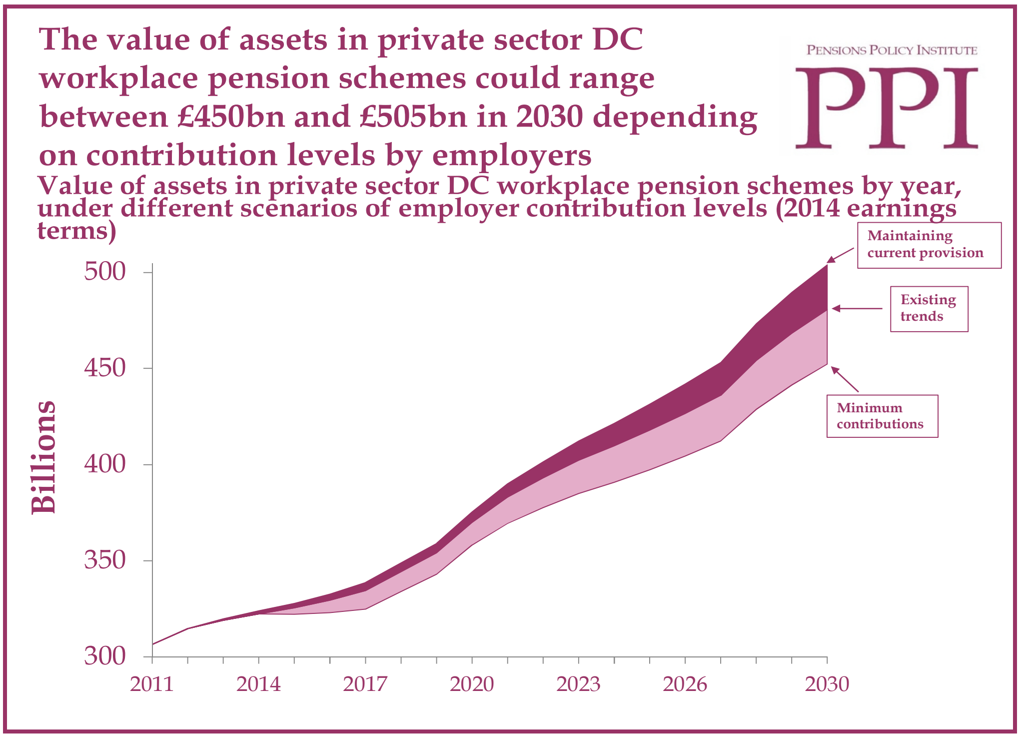


Chart C shows a narrow range of potential outcomes from the employer response scenarios in 2030, of around £55 billion. This is because all of the scenarios assume that a large proportion of those automatically enrolled (around two thirds of working population in 2030) receive minimum required contributions from their employer. This is line with the current behaviour of employers automatically enrolling, and expectations of those who have not yet automatically enrolled and includes workers who become automatically enrolled as a result of starting new jobs.

Therefore, the range above explores what the impact of a range of scenarios could be on employees of those employers who had existing provision prior to automatic enrolment. The scenarios illustrate what could happen if these employees receive either minimum required contributions, contributions in line with existing trends in employer behaviour, or are levelled up to the contribution levels employers maintained before automatic enrolment. The range would be wider if different assumptions were made for the entire working population and is also likely to widen over time.

Conclusion

The research found that that the vast majority of new private sector pension savers arising from automatic enrolment are likely to be saving in Defined Contribution (DC) workplace pension schemes. In the future, DC is likely to dominate in the private sector and the value of private sector DC assets could

[3] PPI Aggregate Model

become greater than the total value of private sector workplace DB assets in around 2036.

The number of new savers and the value of private sector pension assets in future will depend to some extent on the decisions that employers and employees make in response to automatic enrolment. Though there is uncertainty about the future, opt-out rates are currently low at between 9-10% on average, and the majority of employers with existing provision are maintaining current contribution rates for existing scheme members.

The decisions made in future by small to medium sized employers and their workers will depend on many factors including employer decisions and engagement, and workers' perceptions regarding pension saving and affordability.

It is clear that many private sector workers will be reaching retirement with DC savings in the future. From April 2015, people will also have more flexibility in terms of accessing their DC savings. This means that both the nature of the pension savings people reach retirement with and the way people take and use this as income in retirement is also likely to look very different in future from how it does today.

Introduction

The Pensions Act 2008 legislated for the introduction of automatic enrolment into workplace pensions. Automatic enrolment started in October 2012 in a staged process, with the largest employers enrolling their eligible workers into a qualifying workplace pension scheme, in which workers will remain unless they actively opt out. Under the current timetable, all complying employers will have automatically enrolled their qualifying workers by February 2018. The Government has set up the National Employment Savings Trust (NEST) as a low cost scheme for those employers who do not sponsor a pension scheme. NEST has a public service obligation to accept any employer that wishes to use it to fulfil their duties under automatic enrolment obligations. The industry has also set up several pension schemes to provide an alternative for employers wishing to use a new scheme for automatic enrolment, including a number of large, multi-employer schemes.

Automatic enrolment is likely to significantly change the landscape of private pension provision in the UK. The Government has estimated that around 9 million people will be automatically enrolled into a workplace pension scheme, or will contribute more as a result of the policy. With over 85% of private sector Defined Benefit (DB) schemes now closed to future accruals or to new members, a large majority of employers are likely to choose a Defined Contribution (DC) scheme to automatically enrol their workers into.

Within this context, some research questions arise on how employers and employees will respond to automatic enrolment and what will be the impact of the policy on the total levels of pension assets in the UK. This report aims to help answer these questions by identifying the important contributing factors and exploring a range of possible response and outcome scenarios.

Chapter one describes the main aspects of automatic enrolment into workplace pensions in the UK. It then explores the factors that could affect total levels of pension saving such as the decision of employers to contribute at the minimum legal level or above and workers' decisions about whether or not to opt out.

Chapter two explores the effects that different scenarios of member response to automatic enrolment could have on the number of people saving into workplace pensions and the value of private sector workplace pension scheme assets. The chapter also shows the distribution of members between existing provision, and new DC schemes, including multi-employer schemes.

Chapter three explores the effects that different scenarios of employer response to automatic enrolment could have on the value of private sector workplace pension scheme assets.

Chapter one: what factors could affect total pension saving?

This chapter describes the main aspects of automatic enrolment into workplace pensions in the UK and explores how decisions made by employers and employees could affect levels of pension saving.

Automatic enrolment into workplace pensions

In 2005, the Pensions Commission recommended "automatic enrolment" into workplace pensions, a policy which the Labour government then legislated for in the Pensions Act 2008. The roll-out of automatic enrolment began in October 2012 (with the largest employers enrolling qualifying workers) and will finish with smaller and more recently established employers by 1 February 2018.

Under automatic enrolment, workers must be automatically enrolled into a qualifying workplace pension scheme, and are considered "eligible workers", if they are:

- aged between 22 and State Pension Age (SPA),
- not already participating in a qualifying workplace pension scheme, and
- earning at or above the income tax personal allowance level (£10,000 in 2014/15) from at least one single employer.

Workers have a month in which to opt out and have their contributions returned to them. If workers remain in their scheme, they are obligated, with their employer, to pay a minimum level of contributions which are calculated as a percentage of a band of earnings (£5,772 to £41,865 in 2014/15).

Workers, who are not eligible for automatic enrolment have the right to opt in, and are considered "entitled workers", if they are in one of the following groups:

- between the ages of 16 and 21 or State Pension Age and 74 and earning over £10,000 a year

or,

- between the ages of 16 and 74 and earning between £5,772 and £10,000[4]

Employers must pay contributions on behalf of workers in these categories who opt in as well as automatically enrolled workers. The required level of contributions that employers and employees must jointly make into a pension scheme is being phased in from 2012 to reach 8% minimum total contributions on band earnings (£5,772 to £41,865 in 2014/15) by 2018. At minimum levels, the 8% will be made up of 3% from the employer, 4% from the employee and 1% from the Government in the form of tax relief, though employers can choose to pay more than 3% and thereby reduce the amount that their employees are required to contribute. If the employer chooses to pay the entire 8% themselves, then employees who do not opt out are not required to make any contributions

[4] www.thepensionsregulator.gov.uk/employers/opting-in-and-joining.aspx

under automatic enrolment regulations, though their employer may still expect them to contribute.

Table 1[5]: Phasing in of minimum contributions between 2012 and 2018

Phasing of minimum contribution levels	Minimum employer contribution	Minimum employee contribution (includes tax relief)
April 2012 – September 2017	1%	1%
October 2017 – September 2018	2%	3%
October 2018 and after	3%	5%

It is left to the discretion of employers and employees to decide whether they wish to make extra contributions above the minimum.

Employers have a choice regarding which scheme to enrol their workers into
Prior to automatic enrolment, many employers already offered membership in a pension scheme. Some employers, particularly public sector employers, offered membership in a Defined Benefit (DB) scheme, while more recently, employers in the private sector have favoured Defined Contribution (DC) schemes. Many employers who arranged pension provision more recently, chose to offer membership in Group Personal or Stakeholder Pension schemes (Table 2).

Table 2: Different categories of workplace pension schemes[6]

Trust-based pension	A pension scheme taking the form of a trust arrangement, which means that a board of trustees is set up to govern the scheme. Benefits can be either **defined contribution** or **defined benefit**.
Contract-based pension	A **defined contribution** pension scheme purchased by an individual, either through their employer or individually, from a pension provider. It is owned entirely by the individual with the contract existing between the individual and the pension provider.
Defined Benefit (DB) scheme	A **trust-based** pension scheme that provides benefits based on a formula involving how much a person is paid at retirement (or how much a person has been paid on average during their membership of the scheme) and the

[5] www.thepensionsregulator.gov.uk/docs/dg-4-appendix-a.pdf
[6] All definitions quoted directly from DWP (2014c) glossary

	length of time they have been in the pension scheme.
Defined Contribution (DC) scheme	A **trust-based** or **contract-based** pension scheme that provides pension scheme benefits based on the contributions invested, the returns received on that investment (minus any charges incurred) and the rate at which the final pension fund is annuitised.[7]
Hybrid scheme	A private pension scheme which is neither pure **defined benefit** nor **defined contribution** arrangement. Typically a **hybrid** scheme is a **defined benefit** scheme, which includes elements of **defined contribution** pension design.
Group Personal Pension (GPP)	An arrangement made for the employees of a particular employer, or for a group of self-employed individuals, to participate in a **personal pension (DC)** scheme on a grouped basis.
Group Stakeholder Pension (GSHP)	A **personal pension (DC)** that was required to meet certain legislative conditions including an Annual Management Charge (AMC) of no more than 1.5 per cent. Prior to the workplace pension reforms, employers with five or more employees who did not already offer a pension scheme were required to offer a GSHP.[8]

Scheme members can be either:

- ***active***: currently contributing;
- ***deferred***: with past entitlement but no longer contributing due, for example, to changing or leaving employment;
- ***pensioner***: receiving benefits from a DB scheme or having taken their pension pot from a DC scheme in order to provide themselves with income or lump sums in retirement.

Under automatic enrolment, employers can choose to use their existing workplace pension provision as long as it qualifies under automatic enrolment legislation. Those without existing provision, or who wish to change their offer

[7] Or drawdown rate
[8] But were not required to offer contributions

for new or existing members, have the choice to set up and run a Defined Benefit, Hybrid (which sit between DB and DC)or Defined Contribution scheme themselves or to offer their workers membership in a DC scheme run by a third-party such as an insurance company. Some employers may choose to offer a combination of these, offering different options to different categories of workers.

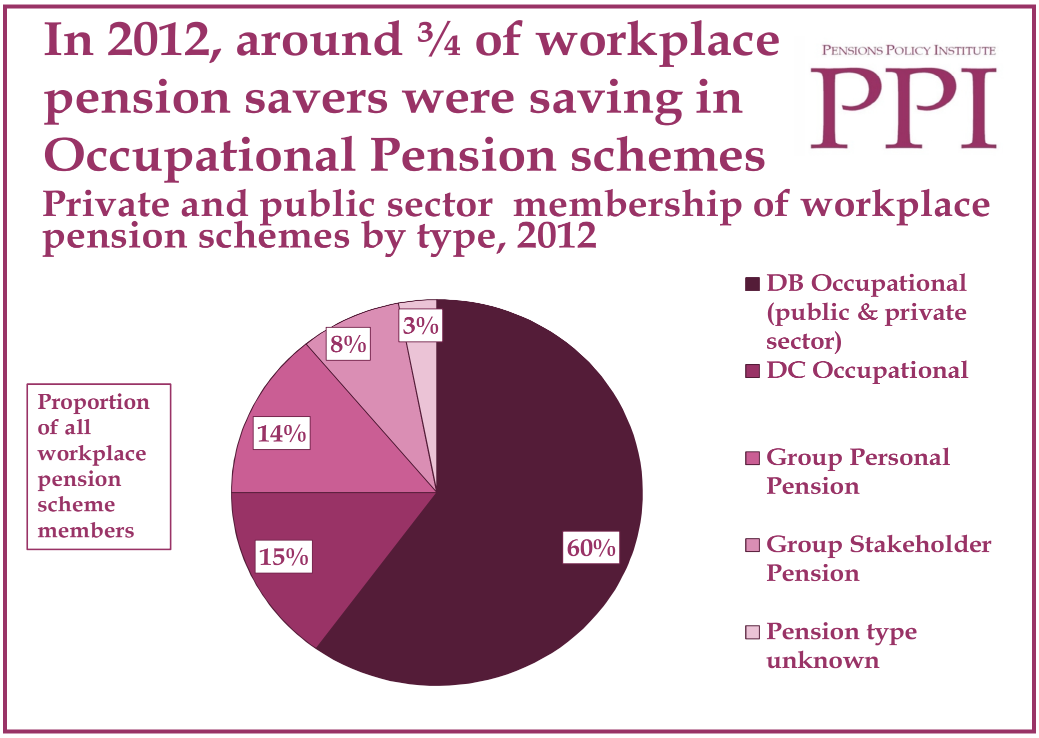
In order to support automatic enrolment, the Government set up the National Employment Savings Trust (NEST); a low cost, workplace, DC pension "master-trust"[9] scheme that can be used by any employer as a qualifying automatic enrolment scheme. NEST, which went live in 2012, is open to any employer to use for automatic enrolment, and is run by an independent board of trustees. There is an annual contribution limit for people enrolled in NEST of £4,600 (2014/15) though the Government has pledged to lift the contribution limit from 2017.[10]

In response to the introduction of automatic enrolment the industry set up or expanded several other, similar, multi-employer schemes, designed to accommodate workers on low-incomes such as, The People's Pension, NOW: Pensions and Legal & General's WorkSave range.

Automatic enrolment will significantly change the UK pensions landscape
In 2012, around 10.9 million individuals (about 55% of workers who would be eligible for automatic enrolment if they were not already saving) were contributing to a workplace pension scheme.[11] Of these, the majority were saving into occupational, trust-based, pension schemes (Chart 1), many of whom were members of public sector pension schemes. The Government has estimated that once automatic enrolment is fully rolled out in 2018 there could be around 9 million people newly saving or saving more as a result of automatic enrolment. The Government has said that it aims for automatic enrolment to increase the amount that is being saved in workplace pensions by around £11 billion per year.[12]

[9] Multi-employer, large scale, trust based pension scheme
[10] DWP Press Release, 9 July 2013 "Government publishes 'Supporting automatic enrolment' paper"
[11] DWP (2013b) p.29
[12] DWP Press Release, 11 April "Pension savings – 9 million newly saving or saving more, says Pensions Minister"; DWP (2013b) p. 72

Chart 1[13]



The number of new members in workplace pension schemes and the total amount of new pension savings that will arise as a consequence of automatic enrolment will depend on several factors, some of which are related to employers' and workers' reactions to the introduction of the policy.

The main factors which will affect future levels of pension saving are:
- Levels of opt out
- Employer responses, in terms of contribution levels and choice of scheme
- Employee contribution levels
- Charges
- Investment returns

The current opt-out rate from automatic enrolment is around 9-10% on average
Workers who are automatically enrolled into workplace pensions are allowed a month in which to opt out and receive back all their contributions to date. If a worker wishes to leave their pension scheme after the one month opt out period, they are permitted to do so, however they will not be able to reclaim their own contributions without paying a tax penalty (of 55%) unless they are over the age of 55.

The level of opt out from automatic enrolment will have a significant impact on future levels of participation in pension schemes and aggregate pension assets. Prior to automatic enrolment, the Government anticipated there might be an opt-

[13] ONS (2013a) p.12, Figure 7.6 – underlying data from Annual Survey of Hours and Earnings

out rate of around 30%.[14] Now that automatic enrolment has begun, the average opt-out rate up until August 2013 was 9-10% across both the public and private sector, and opt-out rates for most individual employers ranged between 5% and 15%.[15] As a result of the very positive start, the Government is now assuming an average opt-out rate of 15% by 2018 and that once fully rolled out, automatic enrolment will result in around 9 million people newly saving or saving more into workplace pensions.[16]

Age is correlated with the decision to opt out
Age appeared to be a major factor in determining opt out decisions in the first year of automatic enrolment. In a study of six employers, opt-out rates for those over age 50 were between 25-50% higher than they were for younger age groups.[17]

The data described below was provided by three automatic-enrolment scheme providers (Legal & General, NEST and The People's Pension), and one employee benefit consultant (JLT), on their experiences of implementing automatic enrolment, covering over 2.6 million of the individuals who have been automatically enrolled.

For automatic enrolment multi-employer schemes,[18] the average overall opt-out rate is currently around 6.5%. The opt-out rate for people aged between 50 and 60 is 11%, while the opt-out rate for lower age groups is 6% or below (Table 3).

Table 3: Opt-out rates using combined data from automatic enrolment, multi-employer schemes[19]

Age band	Opt-out rate[20]
22-30	4.5%
30-40	5%
40-50	6%
50-60	11%
60-65	20%
Total average	**6.5%**

Women and those enrolled at higher contribution rates tended to have higher opt-out rates
Data on the experience of larger employers using multi-employer schemes for automatic enrolment, suggests that:

[14] DWP Press Release, 11 April 2014 "Pension savings – 9 million newly saving or saving more, says Pensions Minister"
[15] Public sector automatic enrolment includes workers who chose not to participate in schemes initially and new employees joining schemes
[16] DWP (2013a) p. 5; DWP (2014a) p. 9; DWP Press Release, 11 April 2014 "Pension savings – 9 million newly saving or saving more, says Pensions Minister"
[17] DWP (2013a) Pp. 5, 7
[18] Excluding NEST due to incompatibility of data
[19] All age groups include NEST other than ages 60 to 65 which exclude NEST due to incompatibility of data
[20] Rounded to nearest 0.5%

- Opt-out rates experienced by men and women are similar but slightly higher overall for women (at 7-8% for women compared to 6-7% for men).
- There is tentative evidence that higher opt-out rates are correlated with the higher initial employee contributions. The data from one source showed that for those with employee contribution rates of 3% or higher there was an average opt-out rate of around 25%, compared to an average opt-out rate of 8% for those with employee contribution rates below 3%. However, other data received suggests that opt-out rates can also vary considerably between employers, between different groups of workers within an employer, and by the employers own contribution rate. Therefore it is not possible to draw any strong conclusions on the relationship between the employee contribution rate and opt-out rates.

Financial constraint was the main reason for opting out

Reasons given for opting out include:[21]

- Financial constraints (the main reason given)
- Proximity to expected retirement
- Plans to change jobs in the near future
- Lack of trust in pensions
- Preference for other forms of saving

Research on who was already saving in a pension scheme before automatic enrolment indicates that tenants may be less likely to do so than home-owners, however there is no available data on whether tenancy status is affecting decisions to opt out. Younger, single men were also less likely to be saving than other groups.[22]

Opt-out rates could be affected by size of employer

Automatic enrolment is being rolled out in stages, starting with the largest employers (based on the number of workers they had in their largest PAYE scheme at 1 April 2012). Employers have three months from their staging date to automatically enrol all of their eligible workers into a qualifying workplace pension scheme.

Table 4: Staging dates for automatic enrolment

Number of workers in largest PAYE scheme at 1 April 2012	Staging Date between:
250+	October 2012 and February 2014
50 to 249	1 April 2014 and 1 April 2015
49 or fewer	1 June 2015 and 1 April 2017

New employers who set up business after 1 April 2012, but before 30 September 2017, have staging dates between 1 May 2017 and 1 February 2018 based not on size but on the first date PAYE is paid in respect of any worker.[23]

[21] DWP (2013b) p. 68, para 3.4.5
[22] SSC ISR (2014) Pp. 6, 57, Figure 10
[23] TPR (2014) Chapter 2, p.7

The first stage of automatic enrolment with the largest employers has just completed. Medium sized employers with 50-249 workers, began to automatically enrol in April 2014.

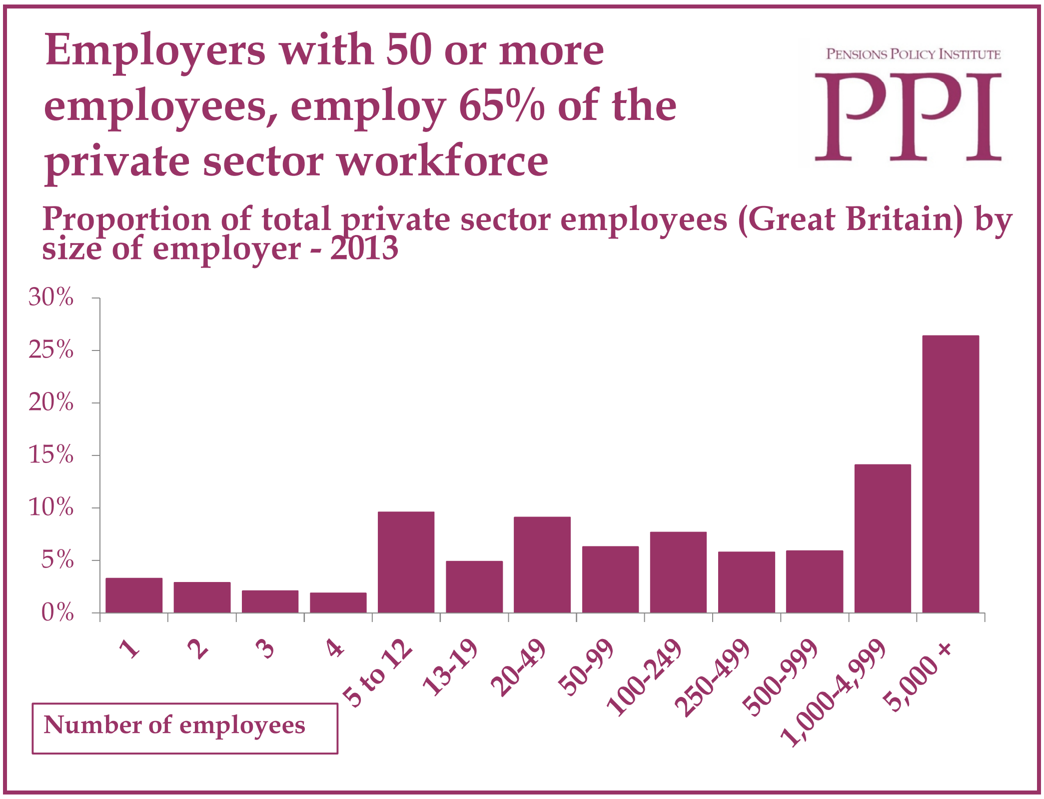
- ***Larger employers*** (with an overall pension participation rate of just under 70%)[24] are more likely to have existing pension provision, and are therefore more likely to have some workers already enrolled in a workplace pension; a more streamlined process for enrolment and contributions; and a higher level of knowledge and awareness about pension saving amongst their employees. However, larger employers also face more complexity when having to assess workers for eligibility and integrate pension payments into complex remuneration structures.
- ***Medium to smaller employers*** who are signing workers up for the first time may face more difficulties in tackling the administrative tasks necessary for setting up and running access to a pension scheme and in engaging with their employees about options under automatic enrolment because they are likely to have fewer HR resources.
- ***Smaller employers*** may be less knowledgeable about their duties under the new regulations and less likely to support the principle of automatic enrolment. Some smaller employers may give workers less encouragement to stay in schemes than larger employers.[25]

Workers who are automatically enrolled by smaller employers may therefore have different experiences than those who work for larger employers. They may be automatically enrolled into different types of schemes, with different contribution rates on offer and may be less likely to have colleagues who are already members of a workplace pension scheme. The attitude of their employer to automatic enrolment is also likely to impact their decision making. Employers who support automatic enrolment may put resources into engaging with workers about their options and may give overt support to remaining enrolled. Some employers who do not support automatic enrolment may, directly or indirectly, encourage workers to opt out, though this could be considered non-compliance.

These factors could all affect average opt-out rates from automatic enrolment when smaller employers begin to automatically enrol their workers. However, larger employers (with 50+ workers) employ around 65% of the private sector workforce (Chart 2) so higher opt-out rates among smaller employers will have less of an impact on overall participation and saving levels.

[24] DWP (2013b) p. 58
[25] DWP (2010) p. 44; DWP (2013b) Pp. 47, 58

Chart 2[26]



Employers may respond in different ways to the extra expense arising as a result of automatic enrolment

Under automatic enrolment legislation, employers are required to make a minimum level of pension contribution on behalf of any worker who does not opt out. The minimum level of contributions will reach 8% in 2018 when automatic enrolment is fully phased in, comprising a minimum 3% from the employer, 4% from the employee and 1% from the Government in the form of tax relief, though employers can choose to pay more than 3% and thereby reduce the amount that their employees are required to contribute. If the employer chooses to pay the entire 8% themselves, then employees who do not opt out are not required to make any contributions under automatic enrolment regulations, though their employer may still expect them to contribute.

Some employers with existing provision already offered contributions above the minimum level prior to automatic enrolment, for example, in 2011, around half of larger employers who offered membership in a Stakeholder or Group Personal Pension scheme had employer contribution rates of 6% of total earnings or over, and for occupational (trust-based) DC schemes, employers contributed around 6.6% of total earnings on average.[27]

The introduction of automatic enrolment carries an extra cost burden for employers who are obligated to administer automatic enrolment, assess eligible

[26] DWP (2014a) Pp. 33-34 Table A.7
[27] ONS (2013b) Pp. 3, 23

workers and pay contributions on behalf of all workers who do not opt out. Only around 40% of private sector employees, on average, participated in their scheme prior to automatic enrolment. Therefore, automatic enrolment represents extra expense if it results in more of their workforce participating.[28]

For employers who did not previously offer a scheme, the extra expense associated with automatic enrolment is increased because they have to fund the costs of setting up and administering access to a pension scheme as well as having to pay contributions on behalf of employees for the first time. Employers with existing provision may also incur expense as a result of having to ensure their existing scheme qualifies or if they decide to arrange alternative provision. The total annual cost to employers, arising from automatic enrolment is estimated to be in the range of £3,000m to £4,500m.[29] Table 5 shows the estimated annual costs to employers, based on size.

Table 5: Estimates of annual cost per employer of paying minimum contributions and set up costs arising from automatic enrolment (2012/13 earnings terms)[30]

Size of employer	1-4	5-49	50-249	250+	Average for all employers
Minimum contributions	£500	£3,000	£22,000	£250,000	£3,500
Administrative cost (1st year)	£250	£350	£1,500	£16,000	£400
Ongoing annual administrative cost	£100	£100	£350	£2,500	£150

Levelling down

Employers could respond in several ways to the extra expense. They could pay the extra costs without passing them on to employees (though costs could also be passed on to shareholders or customers through a decrease in profits or an increase in prices). Alternatively, employers could pass the cost on to their employees through lower or no wage increases in future. Employers who already offer pension provision could "level down" their provision through making new, less generous arrangements available to employees.

Employers with existing provision may level down in one or a combination of the following ways:[31]

- Lower employer contributions for new or existing members
- Change the definition or freeze the level of pensionable pay
- Increase employee contributions

[28] DWP (2013b) p. 56, para 3.2.3
[29] Rounded numbers. DWP (2012) Table 2
[30] DWP (2012a) Table 3
[31] DWP (2013b) p. 75, Box 4.1

- Change the scheme on offer (for example from a DB scheme to a hybrid or DC scheme)
- Offer new members, or certain workers, membership in a different scheme than existing members or other workers
- Change accrual rates on offer in DB schemes

Setting contributions

The contribution levels offered to automatically enrolled workers will have a particular impact on the value of pension savings. PPI research shows that saving a total of 12% of band earnings (rather than the 8% of band earnings minimum under automatic enrolment) into a DC pension scheme could increase income received from private pension savings by 50%.[32]

Employers have the choice to offer the minimum level of contributions required under automatic enrolment (1% currently, phasing in to 3% by 2018) or offer contributions above this level.

Employers reported that contribution costs were a key expense for them in adjusting for automatic enrolment and the majority who have already begun automatically enrolling chose to set contribution levels at the minimum required level. Some employers, however, have offered to match higher contributions (paid over the minimum) from workers. Employers using existing provision were less likely to lower contribution levels for automatically enrolled members than those offering access to a new scheme.[33]

Individuals are allowed to contribute at higher than minimum levels to their DC pensions and may, with or without their employer, boost their final pension pot by doing so.

Scheme charges will affect the value of pension savings

Scheme charges also impact the value of pension savings. Previous PPI research found that an Annual Management Charge (AMC) of 1% could reduce the size of a pension pot by around 24% (at SPA) from what it would have been without charges,[34] a 0.75% charge could result in around a 17% reduction, while a 0.5% charge could result in around a 12-13% reduction.[35]

A recent review of the DC pensions market revealed that charges "levied on scheme members can be difficult to understand and there are a wide range of different costs and charges."[36] The review found that charges were particularly high and complex in older "legacy schemes".[37]

[32] Assumes a median earning man, aged 25 in 2012, contributing into NEST between ages 30 and 68. PPI (2012) Pp. 12-13
[33] DWP (2013b) p. 87, para 5.2.3, p. 74, para 4.3.1
[34] Assuming individual contributes from age 22 to SPA in 2013 (46 years of contributing)
[35] PPI Briefing Note Number 65 (2013) *How do charges affect DC pension outcomes?*
[36] OFT (2013) p. 17, para 1.14
[37] OFT (2013) "Legacy schemes" are pension schemes set up before 2001 when Stakeholder schemes (with capped charges) were introduced

With the introduction of automatic enrolment, pressure has increased on industry and the Government to address the problem of high charges and the lack of transparency as to total charges and their make-up. In response, the Government announced in March 2014 that it will be capping all charges (excluding transaction costs) for default funds in DC qualifying schemes at 0.75% of funds under management from April 2015. In 2012, the average AMC for trust-based workplace pension schemes was 0.71% and for contract-based was 0.95%.[38] The Government is also introducing new governance arrangements for schemes and is consulting on ways to improve transparency by mandating disclosure of costs and charges.[39]

The major multi-employer schemes being used for automatic enrolment typically have lower charges than others and many have an overall annual charge of around 0.5% or broadly equivalent.[40] The low charging level of the largest automatic enrolment schemes may be part of the explanation for a recent downward trajectory in DC workplace pension scheme charges.[41] Lower charges are only part of the equation when considering the value that savers may get for their contributions.

Some stakeholders have highlighted concerns that a charge cap could have "unintended consequences", for example if a cap is set too high, providers could be motivated to level up and charge at the cap level when otherwise they might have charged less, but a low cap could motivate providers to "lower quality and/or impose less visible charges elsewhere."[42]

The investment strategies employed by schemes, particularly in respect of their default funds, will impact on the value of pension savings

Savers in DC pension schemes can choose from a variety of funds ranging from riskier funds, which carry the potential for greater returns, to lower-growth funds, designed for the more risk-averse. There are also a range of other funds designed for individuals with particular needs or principles such as ethical funds or funds which follow Sharia principles.[43]

Qualifying schemes for automatic enrolment must have default fund options for savers who do not wish to make a choice. Default funds are generally "lifestyle" or "target date" funds, which are managed according to the life-stage of the saver. In these funds, younger savers have more of their fund invested in higher risk, and potentially higher return, assets. As savers get closer to their pre-agreed or assumed retirement date, funds are shifted into less risky assets in order to protect the balance of the fund. Around 80% to 90% of existing DC scheme

38 DWP (2012b)
39 DWP (2014b) p.6, para 5
40 e.g., NEST, The People's Pension
41 OFT (2013) p. 106, para 6.14
42 OFT (2013) p. 26, para 1.40
43 For example, funds offered by NEST: www.nestpensions.org.uk/schemeweb/NestWeb/public/NESTforSavers/contents/other-nest-funds.html

members are in the default fund, and this is expected to grow under automatic enrolment. As of March 2014, 99% of NEST members were in the default fund.[44]

PPI research demonstrated that higher-risk investments could boost the median level of income in retirement on average, but also carried a greater risk of reducing pension income if investments did not fare well. There are a range of potential outcomes from any investment approach as they all depend on economic conditions and market performance which is not entirely predictable.[45]

Research on the automatic enrolment target group indicates that the majority of those eligible for automatic enrolment have a low capacity for risk, partly related to the lower contribution levels this group is likely to make, with 37% favouring taking no risk at all with their pension savings.[46] In order to appeal to savers with low risk appetites, NEST and other multi-employer pension schemes, have created lower risk default funds. NEST "retirement date funds" pool all funds for a single retirement target date together in order to smooth out the investment risk between members.[47]

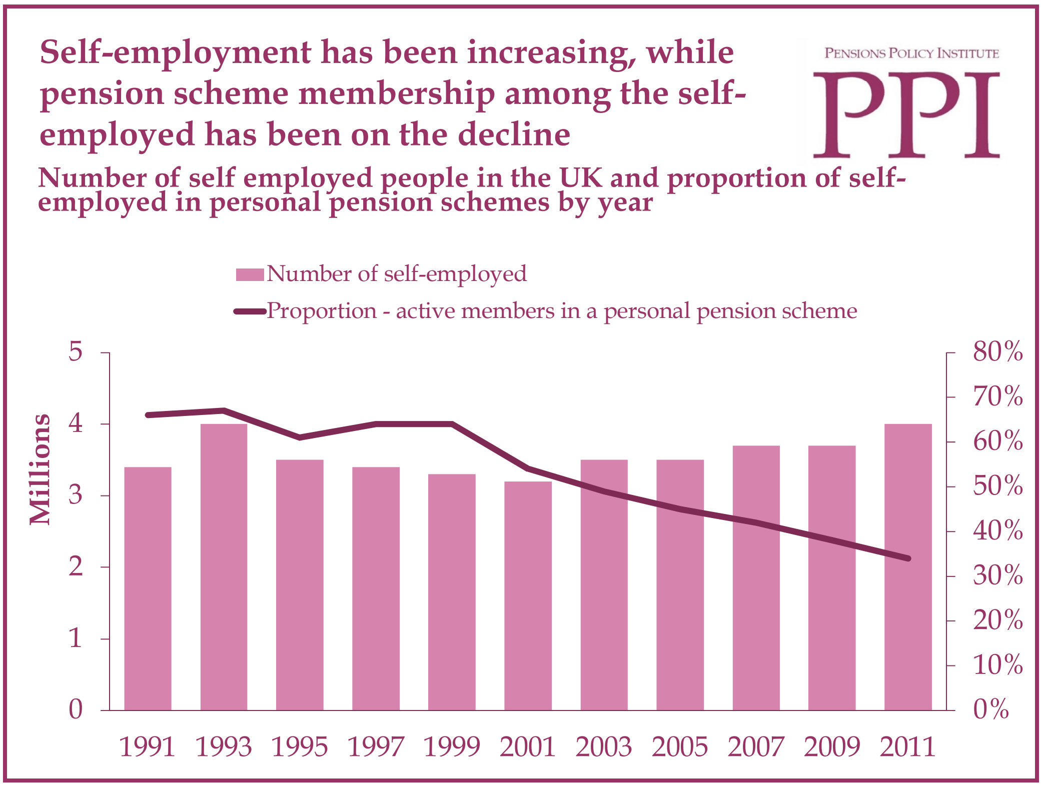
It is expected that the majority of automatically enrolled individuals will have their funds invested in their pension scheme's default fund.[48] Therefore the design of default funds will have an impact on the individual and aggregate size of DC pension assets including the investment returns that they attract.

The Government is aware of the importance of fund design and it is concerned that a cap on default fund charges should not lead to a degradation in fund quality and the focus of providers on ensuring that investment strategies are in the best interest of scheme members. Therefore it is legislating for trustees and governance committees (who will be responsible for oversight of scheme functioning) to have a duty to assess the design, performance, transactions, costs and charges of default funds.[49] It is not yet clear how the changes in legislation including the cap and the governance duties will impact the structure and performance of default funds.

Self-employed people, pension scheme membership and automatic enrolment
Self-employment is on the increase in the UK. In March 1991, there were 3.4 million self-employed people in the UK, compared to March 2014, in which there were 4.5 million.[50] However, the take up of private pension saving by self-employed people has declined over the same time period. In 1991/92, 66% of self-employed people were members of a personal pension scheme, while in 2011, only 34% were members.[51]

[44] DWP (2012c) p. 23, para 44, NEST Press Release, 10 July 2014, "NEST Corporation and NEST Scheme annual reports and accounts 2013/14"
[45] PPI (2012) Pp. 22, 25-26
[46] NEST (2012) p. 4
[47] NEST (2013) p. 13
[48] DWP (2014b) p. 12, para 11
[49] DWP (2014b) p. 47, para 31
[50] Labour Force Survey Data JOBS01 Workforce Jobs
[51] ONS (2013a) p. 18

Chart 3[52]



There are multiple possible explanations as to why fewer self-employed people have decided to save in a personal pension:

- The introduction of the tax advantaged Individual Savings Account (ISA) saving vehicles in 1999 may have attracted some people away from saving in a pension scheme in order to save in an ISA instead;
- The 2008 recession may have also had a role in reducing the number of self-employed people choosing to join or remain in pension schemes;
- Changes in the nature of self-employment and the characteristics and income levels of self-employed people could impact on decisions around pension scheme membership; as could changes to pension scheme charges, commission and the way schemes market their products.[53]

Self-employed people will not be automatically enrolled into pension saving. However, they still have the option of taking out a personal pension, and the option of opting in to NEST if they are between the ages of 16 and 75. Self-employed people who join a personal pension scheme or NEST have no minimum contribution requirement and can contribute in any amount they wish (subject, if in NEST, to the annual contribution limit (currently £4,600 in 2014/15)). At the end of March 2014, 600 self-employed people had opted in to NEST.[54]

[52] ONS (2013a) Figure 7.10; Labour Force Survey data (JOBS01)
[53] ONS (2013a) Pp. 18-19
[54] www.nestpensions.org.uk/schemeweb/NestWeb/public/NESTforSavers/contents/self-employed.html, NEST Press Release, 10 July 2014, "NEST Corporation and NEST Scheme annual reports and accounts 2013/14"

NEST may be an attractive option for some self-employed people as the charges in NEST are lower at an overall average of 0.5% per year at the moment,[55] than those generally found in individual personal pensions, particularly personal pension schemes set up prior to the introduction of Stakeholder Schemes in 2001. The average AMC for pre-2001 schemes is 0.82%.[56]

There is no available evidence yet on whether self-employed people are responding to automatic enrolment by joining personal pension schemes or opting in to NEST. Qualitative research indicates that knowledge of state and private pensions and other financial products is relatively low, on average, among self-employed people. Evidence also shows that many hold negative views about personal pensions and that understanding about tax relief on pension savings is low.[57] This evidence indicates that while some of the 65% of self-employed people not currently saving in a pension scheme might benefit from joining a pension scheme, they may need support and guidance in order to make that decision. Unless a significant proportion of self-employed people choose to join a pension scheme, pension saving may remain low among this group even after automatic enrolment.

Summary

- Automatic enrolment into workplace pension schemes is currently underway.
- There are many different types of schemes which employers can use to fulfil their automatic enrolment duties.
- The Government and the industry have independently set up several multi-employer schemes for the purposes of automatic enrolment.
- The majority of workers who were saving prior to automatic enrolment were doing so in occupational (either DB or DC) pension schemes.
- The main factors which will affect future levels of pension saving are: levels of opt out; employer responses, in terms of contribution levels and choice of scheme; individual contribution levels; charges; and investment returns.
- The current average opt-out rate is 9-10%, the Government assumes that this will grow to around 15% by 2018.
- Those at older ages, women and those enrolled at higher contribution rates may be more likely to opt out.
- Employers who did not offer pension provision prior to automatic enrolment are more likely to automatically enrol workers into a multi-employer scheme and pay only the minimum required level of contributions.
- The proportion of self-employed people saving in pension schemes has decreased over the last decade. Self-employed people will not be automatically enrolled into private pension saving. However, they have the option of joining a personal pension, or opting in to NEST, and paying voluntary contributions.

[55] Annual charges in pension schemes may vary and may be affected by future policies such as Automatic Transfers
[56] OFT (2013) p. 103 para. 6.12
[57] DWP (2006)

Chapter two: how will employee decisions affect the number of people saving and total assets in pension schemes?

This chapter explores the effects that different scenarios of worker response to automatic enrolment could have on the number of people saving into workplace pension schemes and the value of private sector workplace pension assets (contributions net of investment growth and charges over time). The chapter also shows the potential future distribution of members between existing workplace provision and new schemes being used for automatic enrolment.

The following analysis uses data provided by pension scheme providers, an employee benefits consultant and the Government

Three automatic enrolment scheme providers (Legal & General, NEST and The People's Pension), one employee benefit consultant (JLT), and the DWP, provided data from their experiences of implementing automatic enrolment, covering over 2.6 million of the individuals who have been automatically enrolled. The data from Legal & General's WorkSave range included their enrolments for 2013, while the data from other sources typically covered from the introduction of automatic enrolment in October 2012 until spring 2014 (either end of April or May). The data therefore reflects the opt out experience of the larger employers who have reached their staging dates during that time, e.g. employers with more than 250 employees had reached their staging dates by 1st February 2014 and would need to have automatically enrolled their workers within the next three months. The PPI is grateful to these organisations for providing this data.

This data, combined with assumptions about how the implementation experience may change as small to medium sized employers reach their staging dates, as phasing rolls out and as minimum employee contributions increase, has been used to inform the underpinning assumptions in the opt out scenarios explored in this chapter.

The average opt-out rate is currently expected to be around 15% once automatic enrolment staging is complete

Around 11 million people will become eligible for automatic enrolment between 2012 and 2018.[58] Automatic enrolment is now in its second stage. By May 2014, all employers (who had set up before April 2012) with 250 workers or more had automatically enrolled all eligible workers. The current stage (April 2014 to April 2015) requires employers with between 50 and 249 employees to automatically enrol eligible workers within three months of their staging date. The overall opt-out rate across the public and private sector, up to August 2013, was 9-10% and ranged between 5% and 15% for most employers.[59]

[58] DWP (2013c) Page 10

[59] DWP (2013a) p. 5; DWP Press Release, 11 April 2014 "Pension savings – 9 million newly saving or saving more, says Pensions Minister"

Stylised scenarios of employee and employer response

This report uses stylised scenarios to explore the possible effect that employee and employer responses could have on scheme membership and the value of assets in private sector workplace pension schemes. Though there is some evidence available on the responses to the policy by large employers and their workers, there is limited evidence on how small to medium sized employers and their workers may respond or how all workers may respond once minimum employee contributions reach their full level of 4%.

Therefore the scenarios illustrate the potential impact of a *range of scenarios* rather than implying that any scenario is likely, or more likely, to occur.

Other factors, not taken account for, could also impact the outcomes of the scenarios detailed below:

- Investment returns or scheme charges could differ from those modelled,
- DB schemes could close at a faster or slower rate than modelled, and/or
- Demographic or labour market changes, or further changes to the tax and NI thresholds could mean that greater or fewer numbers of people are enrolled into pension saving than assumed.

Automatic Transfers may affect pension savings

The Government is introducing a policy of Automatic Transfers for small pots in or after 2017. This policy will involve "small pots" transferring automatically from a worker's old scheme to their new scheme when they change employment. The details of how the policy will work in practice are not yet finalised and therefore it is not yet known the maximum size of pot the policy will apply to, how transfers will be managed or what the average cost of a transfer under this new system may be to the fund holder. The policy will potentially impact on the aggregate value of pension funds in future, but there is not yet enough detail available to allow for assumptions on automatic transfers to constitute part of the modelling.

What might happen with DB pension assets in the private sector?

The modelling makes certain assumptions about the rate and impact of DB scheme closure in the private sector.

A number of factors have increased the costs of providing DB pension schemes[60] and, as a consequence, over 85% of DB schemes in the private sector are now closed either to new members or to both new members and new accruals (from existing members).[61] 41% of private and "other public sector" schemes that are still open are planning to close their schemes to new members over the next 5 years, and a quarter of open schemes are planning to close to new and existing members over the next five years.[62] Therefore, a large

[60] Such as increased longevity and market-based risks
[61] TPR (2013) Chart 3.1
[62] NAPF (2013) p. 18

majority of those automatically enrolled are likely to be placed in DC pension schemes.

In the future the UK private sector workplace pension landscape is likely to be dominated by DC schemes, although the Government is currently consulting on ways of enabling employers to set up more hybrid schemes (which sit between DB and DC) and schemes which share risk between employees collectively.

PPI analysis indicates that if overall opt-out rates for automatic enrolment stayed level at 15% (given certain economic and labour assumptions described in further detail below) **the value of total private sector workplace DC assets in the UK could become greater than the total value of private sector workplace DB assets in around 2036 at £540 billion. In 2050 the total values of workplace DC and private DB assets could stand at £685 billion and £215 billion respectively (all in 2014 earnings terms).** In the remainder of the analyses we focus on the period between 2012 and 2030, as they allow illustration of how scenarios play out throughout automatic enrolment implementation. The scenario results do not extend beyond 2030, as it becomes increasingly difficult to predict how economic factors and policy changes might impact on pension savings so far into the future.

The analysis does not explore the impact of the new flexibilities in accessing DC pension savings announced in Budget 2014. Forthcoming PPI research will explore the implications of these policy changes in depth.

Throughout this analysis it is assumed (unless otherwise specified) that:

(The scenario assumptions are constructed from data drawn from existing DWP data and scheme data on employer behaviour. Please see the technical annex for a detailed breakdown of underlying data and analysis. The employer response outlined below is the same as in the "existing trends" scenario in Chapter Three.)

- All eligible workers are automatically enrolled; employers fully comply with their automatic enrolment duties.
- No non-eligible workers or self-employed people are assumed to opt in.
- Of newly automatically enrolled workers where employers have existing DC provision:
  - 80% are automatically enrolled at the minimum required contribution levels on total earnings into a new DC scheme set up for automatic enrolment (labelled as "other Automatic Enrolment DC" in charts)
  - 20% are automatically enrolled into their employers existing scheme at their employers' existing contribution level
- Of existing members of DC workplace schemes:
  - 80% remain in their current scheme at current contribution levels
  - 20% are moved into a new, automatic enrolment DC scheme and have their contribution levels reduced to minimum required levels under automatic enrolment (on total earnings)

- All employers without existing provision automatically enrol new workers into multi-employer schemes and both employers and employees pay the minimum required contribution level on band earnings (contributions rise from 2% in 2012 to 8% in 2018) (band earnings: £5,772 to £41,865 in 2014/15).
- Total employer/employee contributions in existing workplace DC schemes are assumed to be 9% of gross earnings on average rising to 11% by 2030 to reflect higher compensation from employers who have replaced DB schemes.
- Investment returns on pension funds average 6%[63]
- Funds in multi-employer DC schemes are subject to a 0.5% total Annual Management Charge (AMC) (no other charges are assumed to be levied)[64]
- Funds in other workplace DC schemes are subject to a 0.75% total (no other charges are assumed to be levied)[65]
- DB schemes close at a constant rate, resulting in 80% of private sector DB scheme members' schemes closing to new members and new accruals between 2010 and 2030
    - The proportion of workers who would have joined the closed DB schemes join private sector DC workplace schemes.
- The displacement of members, leaving one type of scheme and entering another (as a result of movements in and out of the labour market or between jobs) results in roughly the same proportions of the workforce in different types of schemes, apart from new members of DC schemes who are split between automatic enrolment schemes and existing workplace DC schemes in the proportions outlined above.

In the presentation of analysis results, all scheme members are rounded to the nearest 0.5 million. Overall pension assets are rounded to the nearest £10 billion and DC assets are rounded to the nearest £5 billion.

The way that employees respond to automatic enrolment will affect the number of people saving in workplace pension schemes

This chapter explores how different opt-out rates by workers might affect the number of people saving and the value of assets (contributions net of investment returns and charges) in private sector workplace pension schemes. The following scenarios are explored:

- **The "no automatic enrolment" scenario** – a baseline scenario which explores the impact of not introducing automatic enrolment
- **The "central opt-out rate" scenario** - a scenario which explores the impact of a 15% opt-out rate
- **The "low opt-out rate" scenario** - a scenario which explores the impact of a 9% opt-out rate

[63] See technical annex for further details on assumptions
[64] Average total charges for current automatic enrolment multi-employer schemes
[65] In 2012, the average AMC for trust-based workplace pension schemes was 0.71% and for contract-based was 0.95%, ref: DWP (2012b). All workplace pension schemes will have total charges (excluding transaction costs) capped at 0.75% from April 2015. Therefore the modelling assumes an average charge of 0.75% for pre-automatic enrolment schemes to take account for both higher and lower charges.

- **The "high opt out rate" scenario** - a scenario which explores the impact of a 25% opt-out rate

The "no automatic enrolment" scenario
In order to allow comparison between the scenarios, a "no automatic enrolment" scenario is set out, which explores the effect that not introducing automatic enrolment could have on the numbers of people and total saving in private sector workplace pensions.

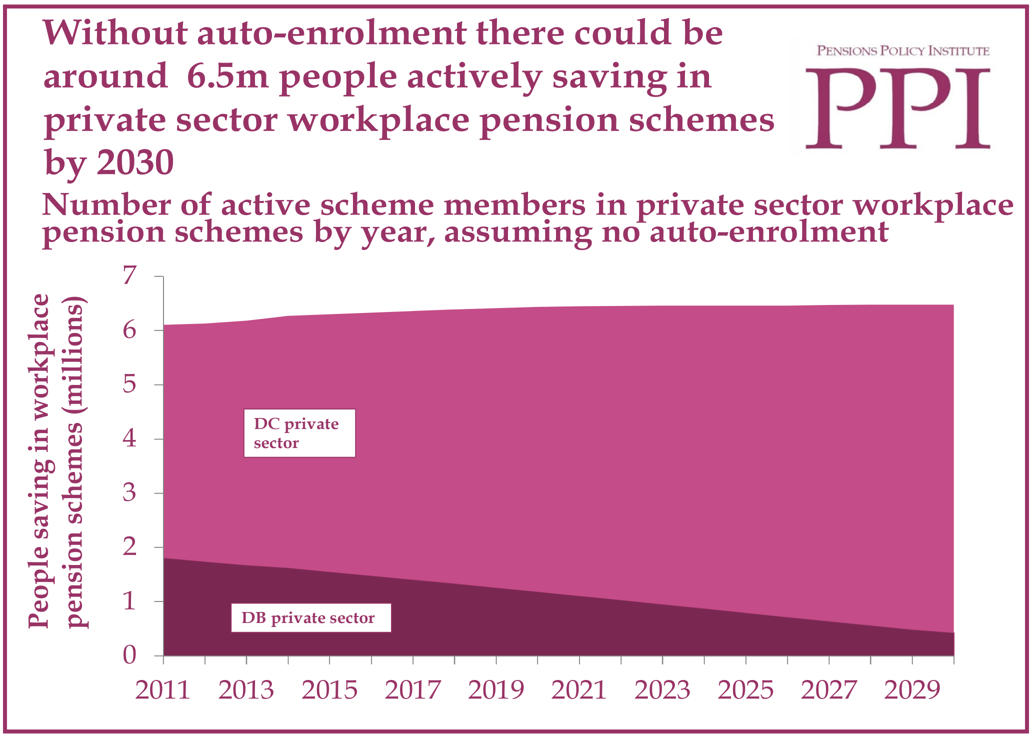
No automatic enrolment could result in 6.5 million people saving in private sector workplace pension schemes by 2030
If it is assumed that:

- Automatic enrolment does not take place.
- New automatic enrolment schemes do not exist.
- The proportion of private sector employees in DC workplace pension schemes remains at pre-automatic enrolment levels of 17.5% (excepting for additional off-flow from DB private sector schemes.)
- With their employers, scheme members contribute 9% of gross salary increasing to 11% by 2020 to reflect higher contribution levels in schemes transitioning from DB to DC.

Throughout this report, total private sector workplace pension scheme membership is presented only for 2030 because numbers do not change significantly between 2018 and 2030 and DB asset growth may not be directly comparable with DC asset growth, as DB assets include funds being used to pay retired members/pensioners. Where relevant, DC scheme membership is presented for both 2018 and 2030 as private sector DC schemes are most affected by automatic enrolment.

Without automatic enrolment there could be around 6.5 million people actively saving in private sector workplace pension schemes by 2030

Chart 4[66]

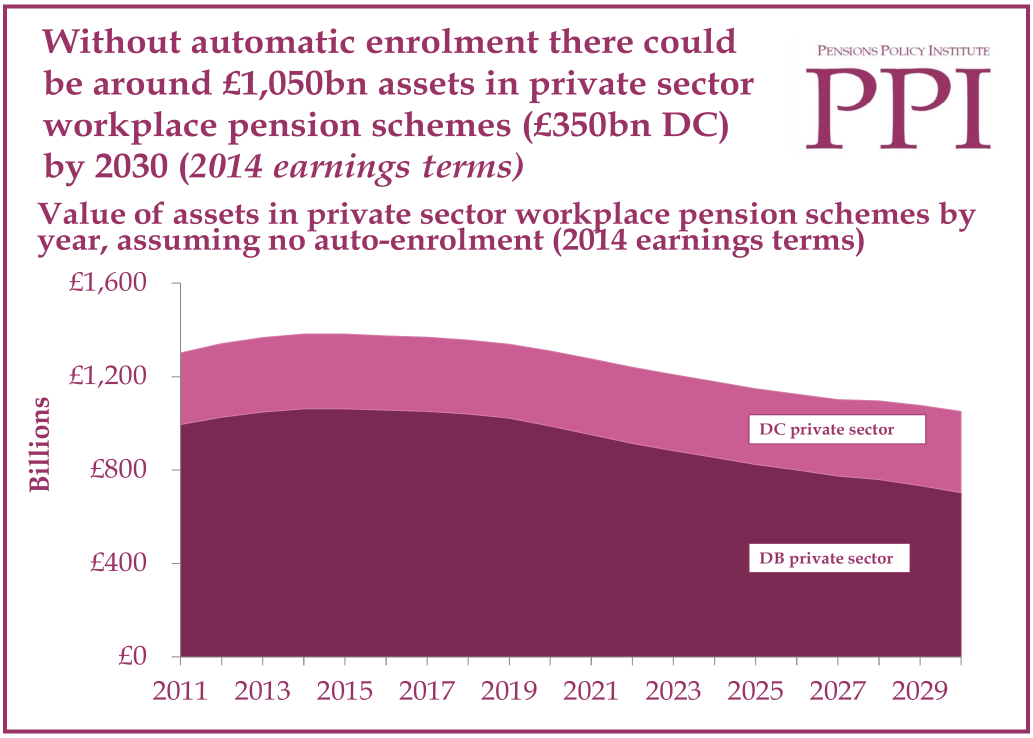


- **by 2030** around ***6.5 million people*** could be saving in private sector workplace pension schemes, with around ***6 million*** of these saving in DC schemes (Chart 4)

[66] PPI Aggregate Model

Without automatic enrolment there could be around £1,050bn assets in private sector workplace pension schemes (£350bn DC) by 2030 (2014 earnings terms)

Chart 5[67]



Total assets

- **by 2018** there could be around £1,360 billion total assets in private sector workplace pension schemes,
- **by 2030** this could decline to around £1,050 billion (2014 earnings terms), partly as a result of the decline in Defined Benefit scheme membership.

DC assets

- **by 2018** there could be around £315 billion in DC assets in private sector workplace pension schemes,
- **by 2030** this could increase to around £350 billion (2014 earnings terms) (Chart 5)

[67] PPI Aggregate Model

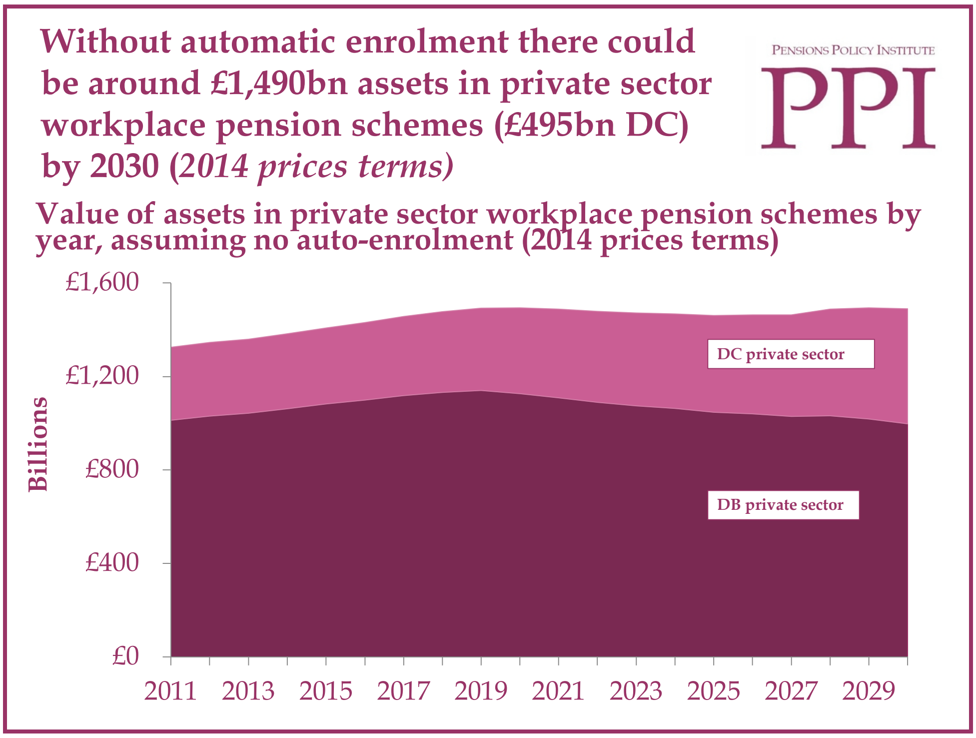
An illustration in prices terms

Chart 6 shows the results in earnings terms

Scheme assets in this report are presented in earnings terms. Showing pension assets in prices terms may not be as useful for seeing how people's assets are growing relative to the rest of the economy. It can be more useful to measure wealth and savings in terms of earnings because it allows for comparisons with economic growth and increases in earnings. Expressing pension savings in earnings terms also makes it easier to make inferences about the standard of living people might expect to have in retirement.

Chart 6 shows the value of assets in private sector workplace schemes under a scenario of "no automatic enrolment" *in prices terms* in order to illustrate how price inflation can change the way asset growth appears.

Chart 6[68]



Total assets prices terms

- **by 2030** this could decline to around £1,490 billion (2014 earnings terms), partly as a result of the decline in Defined Benefit scheme membership.

DC assets prices terms

- there could be around £495 billion in DC assets in private sector workplace pension schemes (2014 earnings terms) (Chart 6)

The rest of the results in this report are expressed *in earnings terms*.

[68] PPI Aggregate Model

The remaining charts focus on the impact of the scenarios on DC under automatic enrolment, where the greatest impacts are observed. DB membership and assets do not vary greatly between the scenarios as the majority of automatic enrolment is assumed to be into DC schemes.

The "central opt-out rate" scenario

It is expected that the number of opt-outs will increase when medium and smaller employers, who are less likely to have existing pension provision, begin to automatically enrol. These employers may have fewer resources to devote to communication and engagement with employees regarding pension saving, and may be less likely to actively support automatic enrolment.

Opt-out rates may also increase in line with rises in the minimum contribution rate that employees who do not opt out are required to pay; rising from 1% currently, to 3% in 2017, and 5% after (though these levels include tax relief and therefore represent slightly less than the full 1%, 3%, and 5% of earnings.)

Data provided by external sources indicates that automatically enrolling workers at higher employee contribution rates may be linked to higher opt-out rates. One set of data on the experience of around 200 employers and around 150,000 workers showed that workers automatically enrolled with an employee contribution rate of 1-2% had an average opt-out rate of around 8%, which rose to an opt-out rate of around 22% for those automatically enrolled with an employee contribution rate of 3-4%.[69]

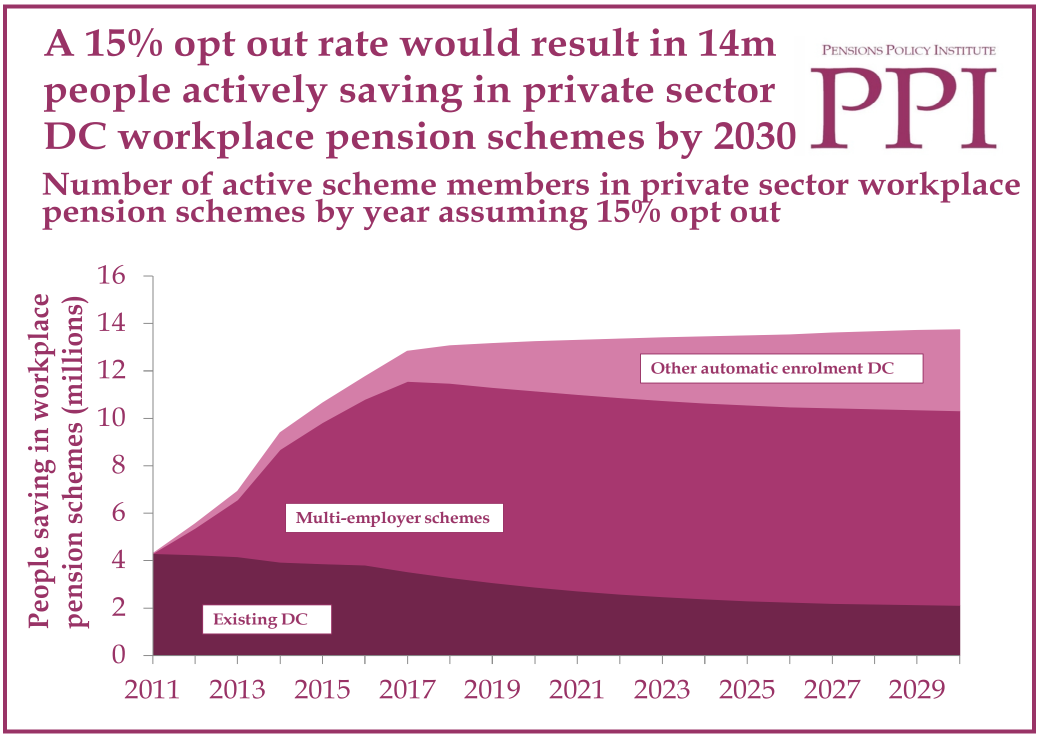
The Government is currently assuming an average opt-out rate of 15%, for the life of the programme.[70] There is significant uncertainty around the future opt-out rate. This report has shown that there is some evidence that opt-out rates could rise when minimum contribution levels are raised and when small to medium sized employers automatically enrol. Though research into auto-escalation of contributions suggests that gradual increases have less impact on opt-out rates than an initial high rate of contributions. On the other hand, the Budget changes announced in March 2014, introducing more flexibility to the way people access their DC savings, could reduce opt outs among those who value flexibility. The extent to which these factors will influence opt-out rates in future is not known. The central assumption of 15% opt out in this report is based on the evidence currently available.

[69] Data provided to the PPI by organisations involved in automatic enrolment implementation
[70] DWP (2013a) p. 5; DWP Press Release, 11 April 2014 "Pension savings – 9 million newly saving or saving more, says Pensions Minister"

A 15% opt-out rate could result in 14 million people saving in private sector workplace DC pension schemes by 2030, an increase of around 7.5 million over the "no automatic enrolment" scenario

If it is assumed that:
- A total of 15% of those automatically enrolled opt out through-out the life of the automatic enrolment staging and phasing process, and on an ongoing basis thereafter.

Chart 7[71]



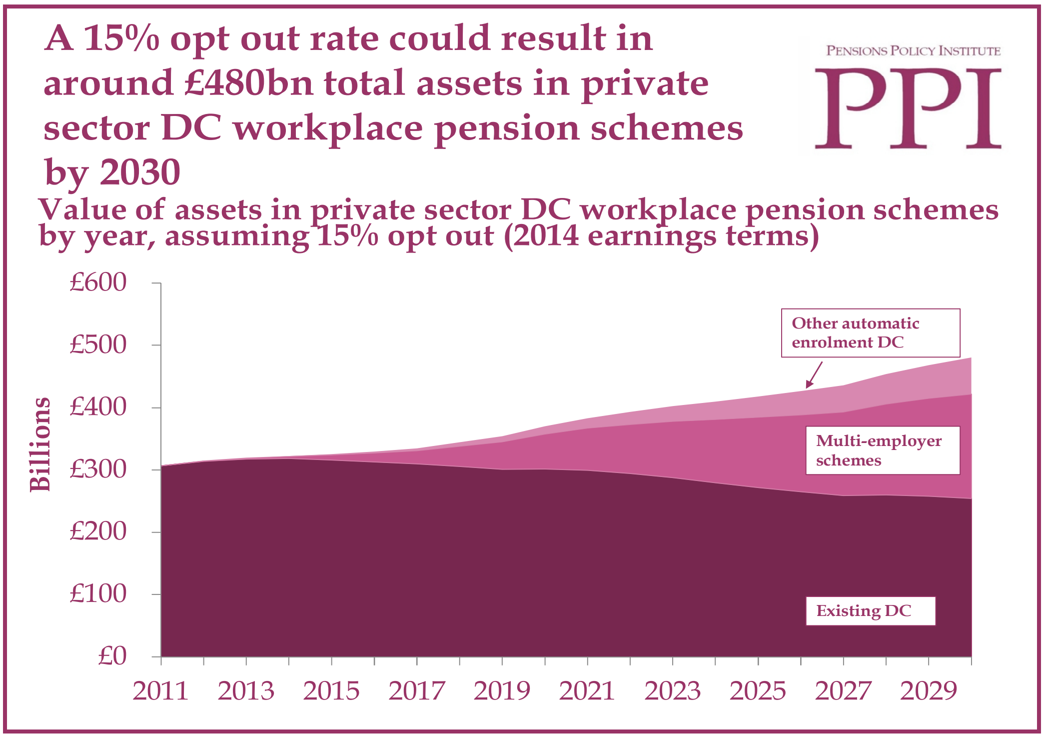
Scheme members
- **by 2030** around 7.5 ***million people could be newly saving*** in a private sector workplace pension scheme, and
- around ***14 million people in total*** (including new and existing savers) could be saving in a private sector workplace pension scheme, the majority of these in DC schemes (Chart 7)

DWP estimates that around 9 million people may be newly saving ***or*** saving more as a result of automatic enrolment. The PPI analysis looks only at those who would be newly saving, i.e., people who would not be saving were it not for automatic enrolment. Therefore, PPI estimations of numbers of savers arising from automatic enrolment may appear lower than DWP's, because the PPI is looking only at ***new savers***, while DWP estimates also include those who ***may be saving more***.

[71] PPI Aggregate Model

A 15% opt-out rate could result in around £480 billion DC assets in private sector workplace pension schemes by 2030 (2014 earnings terms):

Chart 8[72]



Total assets

- **by 2018** there could be around £1,380 billion total assets in private sector workplace pension schemes
- **by 2030** this could decline to around £1,180 billion total assets (2014 earnings terms), partly as a result of the decline in DB scheme membership

DC assets

- **by 2018** there could be around £345 billion (2014 earnings terms) in DC assets in private sector workplace pension schemes,
- **by 2030** this could rise to around £480 billion. (Chart 8)
- This is around £130 billion more in DC assets by 2030 than under the "no automatic enrolment" scenario

[72] PPI Aggregate Model

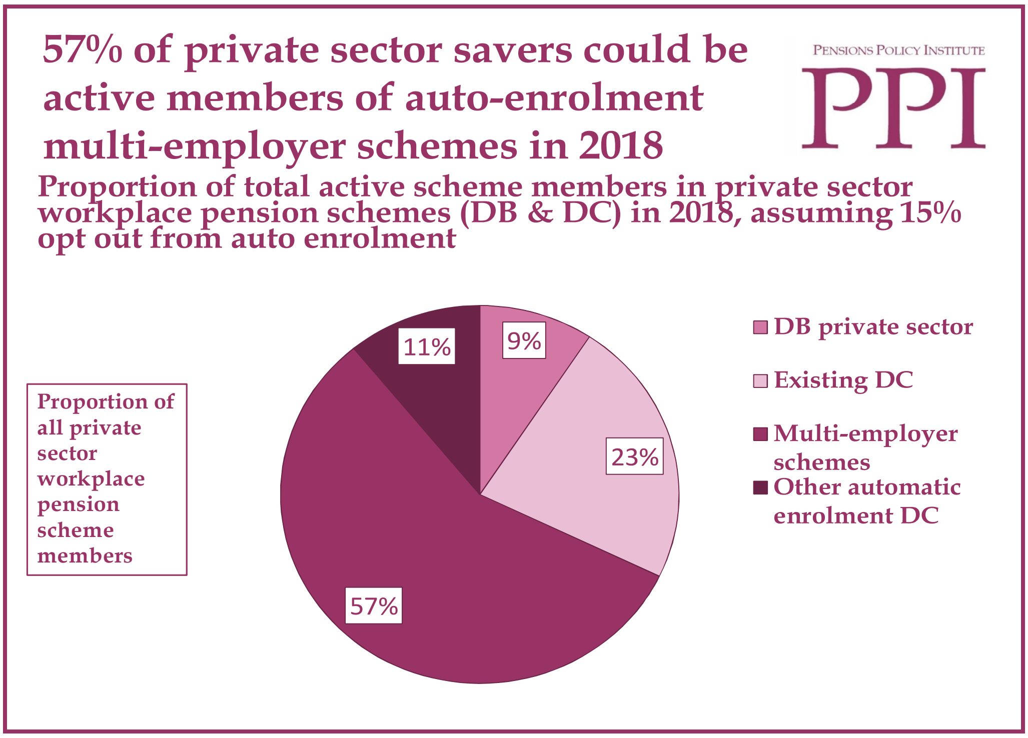
57% of private sector savers could be members of automatic enrolment multi-employer schemes in 2018

Employers with existing provision may automatically enrol their workers into their existing schemes or may set up new provision and automatically enrol into new schemes. In Chart 9, existing provision is labelled **"DB private sector"** or **"Existing DC"**.

Some employers with existing provision and many who do not have existing provision are likely to automatically enrol workers into an automatic enrolment, multi-employer scheme, designed to appeal to smaller employers and those with employees on low-incomes, labelled **"Multi-employer schemes"**.[73]

Others may automatically enrol into contract-based DC schemes which are set up for automatic enrolment but are not multi-employer schemes, labelled **"other automatic enrolment DC"**.

Chart 9[74]



Under the 15% opt out assumption, 57% of private sector savers could be members of automatic enrolment multi-employer schemes in 2018 (Chart 9).

The "high opt-out rate" scenario

People may opt out in greater numbers in the future than is currently estimated. Higher opt-out rates than expected could result from one, or a combination of, different factors including, but not limited to:

[73] For example, NEST, The People's Pension, Legal & General's WorkSave range, NOW: Pensions
[74] PPI Aggregate Model

- Employer behaviour, such as
  - reacting to extra costs of automatic enrolment by freezing or reducing wages overtime and thereby making pension saving appear less affordable to employees,
  - non-engagement with employees or a clear lack of support for automatic enrolment
  - non-compliance with automatic enrolment through, for example, explicit incentives to opt out or through failure to automatically enrol at all.

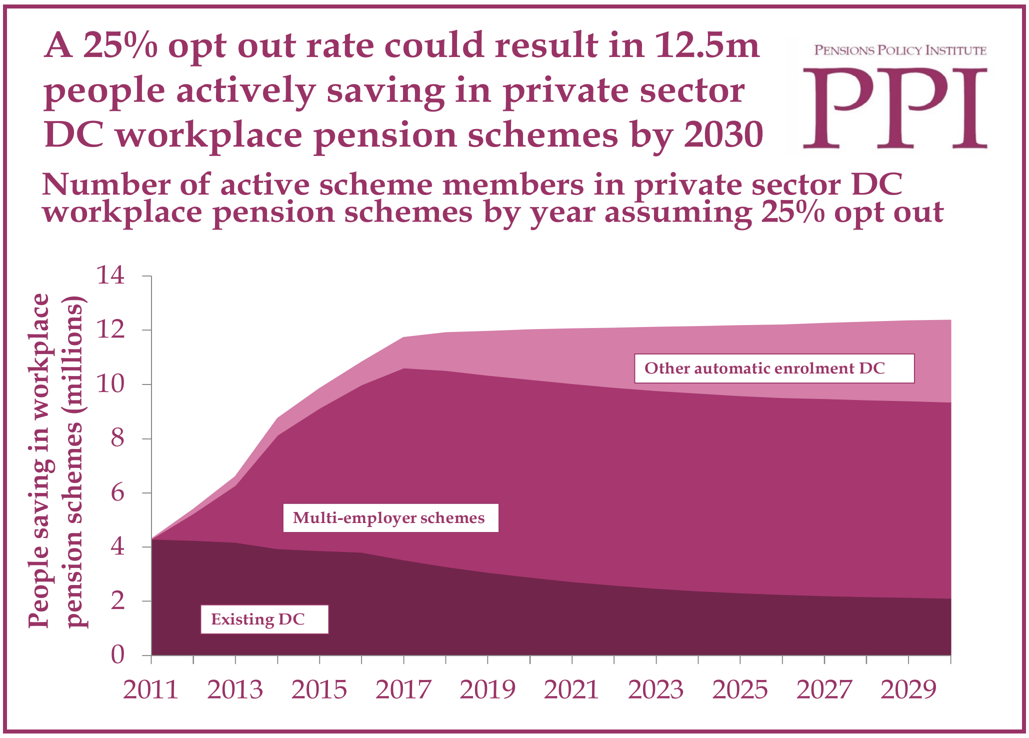
- Employee behaviour:
  - Economic changes (which cause relative price rises, pay freezes or other problems) making pension saving appear less affordable to employees,
  - Opt outs increasing relative to each rise in minimum employee contributions (minimum employee contributions, for those who remain enrolled are rising in stages from 1% to 4% between 2012 and 2018). Workers with constrained budgets, high levels of debt or great demands on their income may be especially sensitive to rises in the minimum employee contribution level.

It is not yet clear how opt-out rates will change during the later stages of automatic enrolment, however it is useful to explore the range of possible outcomes and to consider how different employee responses could affect overall opt-out rates. PPI calculations show that if medium to smaller employers experience significantly higher opt-out rates than larger employers of 30% (original DWP opt-out rate estimate), whilst larger employers opt-out rates remain at around 10%, then total opt outs for automatic enrolment would average around 25%. Similarly, if medium to smaller employers experience slightly higher opt-out rates (e.g. of 25%) than larger employers, and larger employers' opt-out rates drift up (e.g. to 15%) between now and 2018 because of rising minimum employee contributions, then total opt outs for automatic enrolment would average in the range of 20-25%. We have therefore assumed a 25% opt-out rate as a plausible 'high opt-out rate' scenario.

A 25% opt-out rate could result in 12.5 million people saving in private sector DC workplace pension schemes by 2030, an increase of 6.5 million over the "no automatic enrolment" scenario

If it is assumed that:
- A total of 25% of those automatically enrolled opt out through-out the life of the automatic enrolment staging and phasing process, and on an ongoing basis thereafter

Chart 10[75]

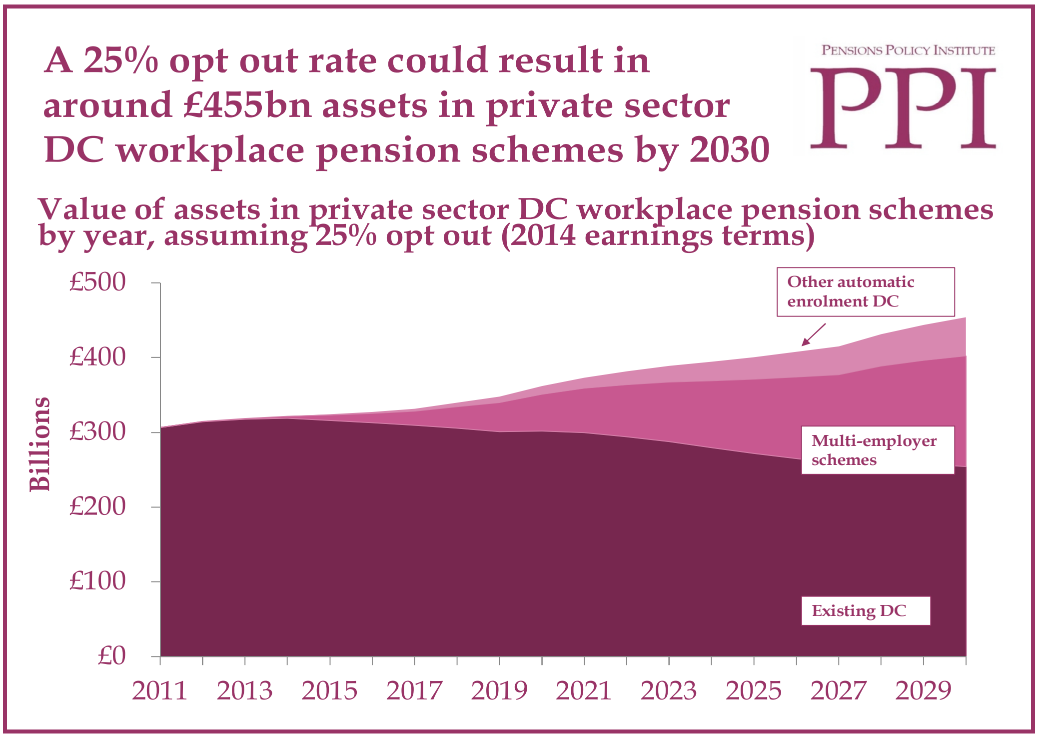


Scheme members
- **by 2030** around ***6.5 million people would be newly saving*** in a private sector DC workplace pension scheme, and
- around ***13 million people in total*** could be saving in a private sector workplace pension scheme, ***12.5 million of these saving in DC schemes*** (Chart 10)
- This is around 6.5 million more than under the "no automatic enrolment" scenario, but 1.5 million less than under the "central opt-out rate" scenario (figures may not total due to rounding).

[75] PPI Aggregate Model

A 25% opt-out rate could result in £455 billion DC assets in private sector workplace pension schemes by 2030 (2014 earnings terms):

Chart 11[76]



Total assets

- **by 2018** there could be around £1,380 billion total assets in private sector workplace pension schemes
- **by 2030** this could reduce to around £1,160 billion total assets (as a result of DB decline) in 2014 earnings terms

DC assets

- **by 2018** there could be around £340 billion (2014 earnings terms) in DC assets in private sector workplace pension schemes,
- **by 2030 this** could rise to £455 billion. (Chart 11)
- This is a rise of £105 billion more in DC assets by 2030 than under the "no automatic enrolment" scenario

[76] PPI Aggregate Model

The "low opt-out rate" scenario
People may opt out in lower numbers in the future than is currently estimated if employees find the pension savings offers from small to medium sized employers more attractive than expected under current assumptions.
This could happen if:

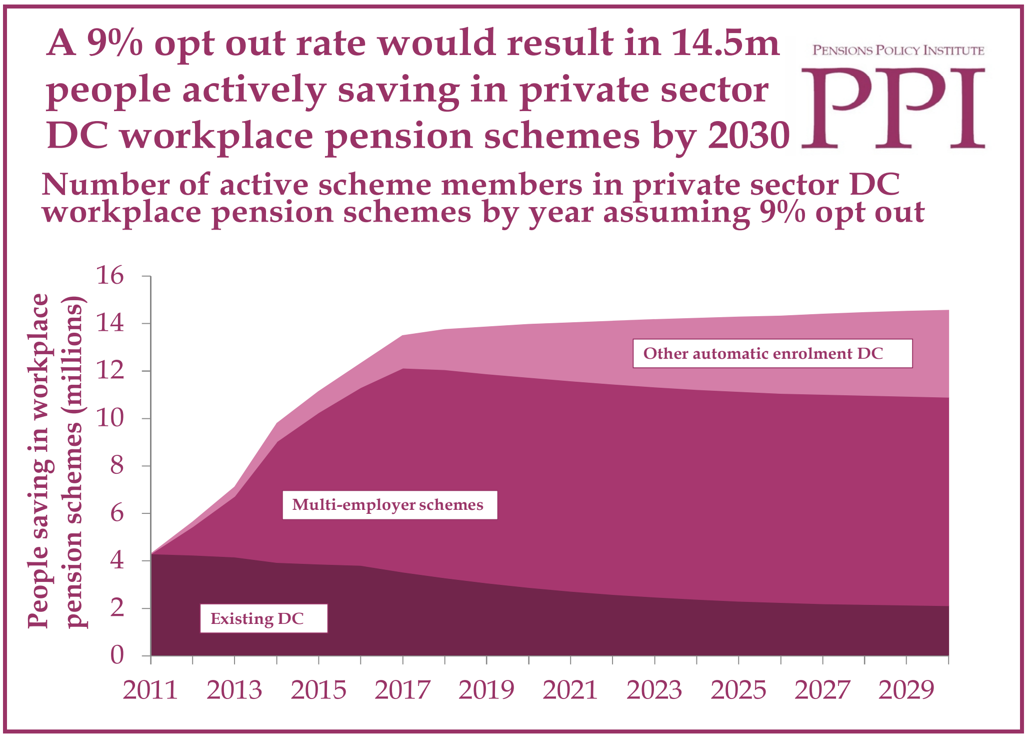
- More individuals believe that saving in a pension is affordable than expected (this could result from more generous wage increases than expected, economic growth leading to higher wages or lower relative price inflation, or divergence in expected behaviour).
- The Budget 2014 announcements regarding greater flexibilities for accessing DC pension savings encourage more people to save in DC schemes.
- There are fewer opt outs than expected by those who are re-automatically enrolled (those who opt out will be re-automatically enrolled every three years) or those who are automatically enrolled into a new scheme when they change employer.

A 9% opt-out rate could result in 14.5 million people saving in private sector DC workplace pension schemes by 2030, an increase of 8.5 million over the "no automatic enrolment" scenario

If it is assumed that:

- Opt-out rates do not increase as medium to smaller employers automatically enrol, but remained at the same overall level that they are at currently, 9%, throughout the life of the automatic enrolment staging and phasing process, and on an ongoing basis thereafter.

Chart 12[77]



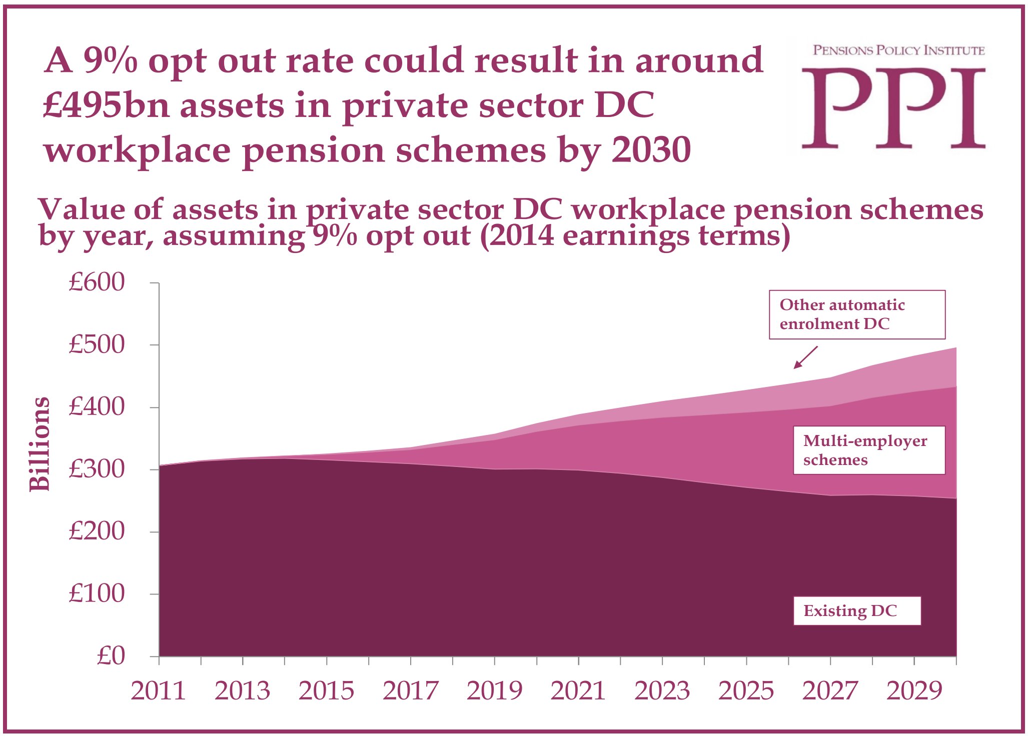
Scheme members

- **by 2030** around ***8.5 million people would be newly saving*** in a private sector DC workplace pension scheme, and
- around ***15 million people in total*** could be saving in a private sector workplace pension scheme, ***14.5 million of these saving in DC schemes*** (Chart 12)

[77] PPI Aggregate Model

A 9% opt-out rate could result in around £495 billion assets in private sector DC workplace pension schemes by 2030 (2014 earnings terms):

Chart 13[78]



Total assets

- **By 2018** there could be around £1,390 billion total assets in private sector workplace pension schemes
- **By 2030** this could reduce to around £1,200 billion total assets (2014 earnings terms)

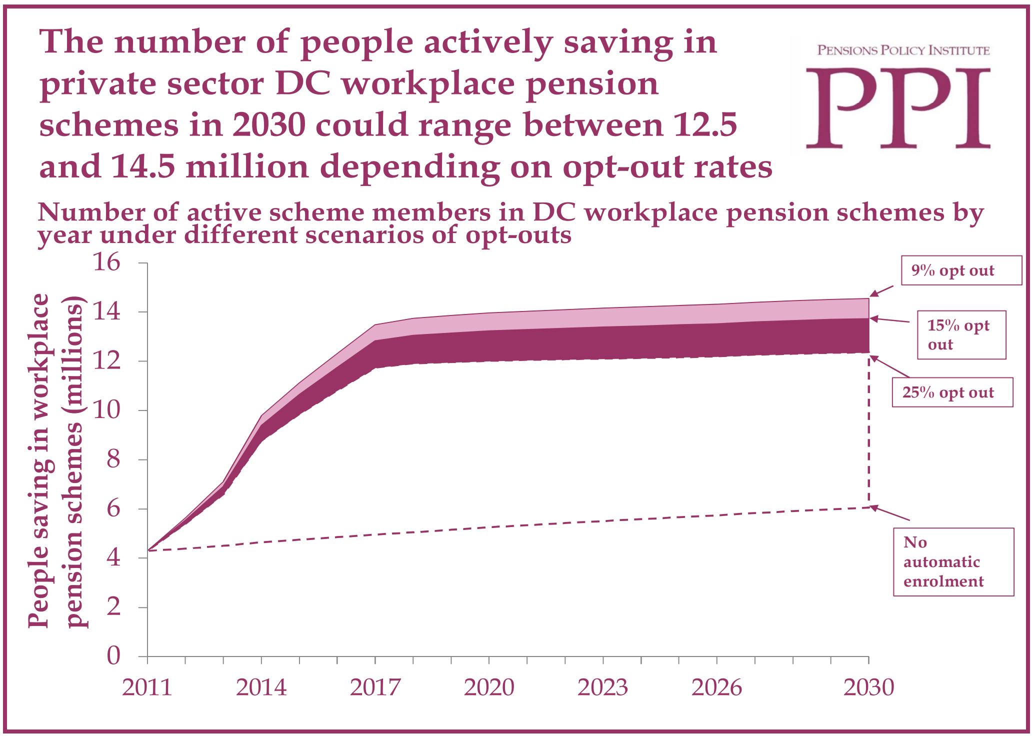
DC assets

- **By 2018** there could be around £345 billion (2014 earnings terms) in DC assets in private sector workplace pension schemes,
- **By 2030** this could rise to around £495 billion. (Chart 13)
- This is a rise of around £145 billion more in DC assets by 2030 than under the "no automatic enrolment" scenario

[78] PPI Aggregate Model

The following charts show the range of potential outcomes based on the scenarios of employee response to automatic enrolment
The vast majority of those automatically enrolled will be enrolled into DC private sector workplace pension schemes.

Chart 14[79]

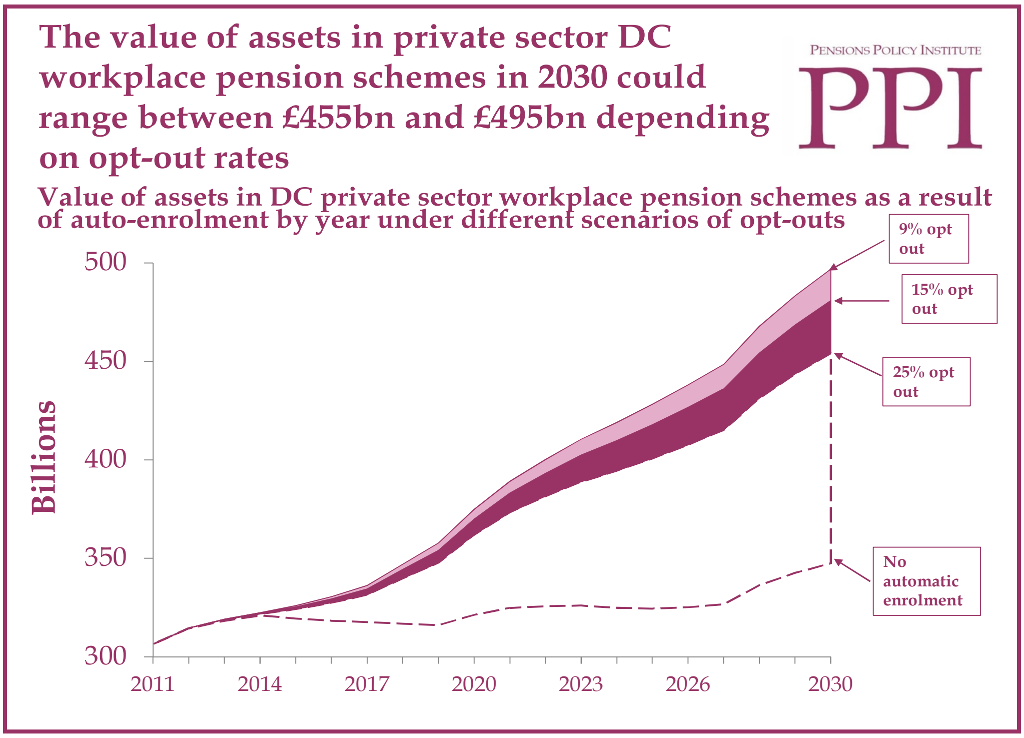


This analysis indicates that, (assuming a reasonable range of opt outs; no less than 9% opt out and no more than 25% opt out):

- **By 2018** the number of people saving in private sector DC workplace pension schemes could range between 12 and 13.5 million
- **By 2030** the number of people saving in DC workplace pension schemes could range between 12.5 and 14.5 million (Chart 14).

[79] PPI Aggregate Model

Chart 15[80]



This analysis indicates that:

- the value of assets in DC private sector workplace pension schemes in 2030 could range between £455 billion and £495 billion (2014 earnings terms) as a result of opt-out rates, (assuming a reasonable range of opt outs; no less than 9% opt out and no more than 25% opt out) (Chart 15).
- The technical annexe explores the impact of different investment growth assumptions on the scenario outcomes.

[80] PPI Aggregate Model

Summary
This chapter uses data provided by three automatic enrolment scheme providers (Legal & General, NEST and The People's Pension), one employee benefit consultant (JLT), and the DWP to explore how different scenarios of employee response to automatic enrolment could affect the numbers of people saving in private sector workplace pension schemes and the value of assets in these schemes. The scenarios explored a range of opt out scenarios and illustrated the potential effect of a reasonable range of opt-out rates. The scenario analysis found that, given a set of assumptions (explained in detail in the technical annex), a scenario in which "no automatic enrolment" took place could result in:

- Around ***6.5 million saving in private sector workplace pension schemes by 2030***
- Around ***£1,360 billion total assets in private sector workplace pension schemes by 2018*** which could ***decline to around £1,050 billion by 2030*** (2014 earnings terms)
- Around ***£315 billion DC assets in private sector workplace pension schemes by 2018*** which could ***increase to around £350 billion by 2030*** (2014 earnings terms)

Automatic enrolment with an opt-out rate of between 9% and 25% could result in a range of outcomes for private sector workplace pension schemes:

Scheme members

- **By 2030** between 13 and 14.5 million people could be saving in a private sector workplace pension scheme

Total assets

- **By 2030** the value of assets in private sector workplace pension schemes could range between £1,160 billion and £1,200 billion (2014 earnings terms)

DC scheme members

- **By 2018** the number of people saving in private sector DC workplace pension schemes could range between 12 and 13.5 million
- **By 2030** the number of people saving in private sector DC workplace pension schemes could range between 12.5 and 14.5 million

DC assets

- **By 2018** The value of assets in DC private sector workplace pension schemes could range between £340 billion and £345 billion
- **By 2030** The value of assets in DC private sector workplace pension schemes could range between £455 billion and £495 billion (2014 earnings terms)

Chapter three: how will employer decisions affect the value of assets in pension schemes?

This chapter explores the effects that different scenarios of employer response to automatic enrolment could have on the number of people saving into workplace pensions and the total amount of workplace DC pension saving assets.

The way that employers respond to automatic enrolment will affect the number of people saving in workplace pension schemes
Extra costs will arise for all employers as a result of having to ensure they are complying with automatic enrolment regulations, whether they previously offered access to pension saving or not. Some employers may respond to this extra cost by offering only minimum required contributions or "levelling down" existing provision (see Chapter one for further description of costs associated with automatic enrolment and of the ways in which employers could level down).

Some employers were reducing the value of their pension saving offer prior to the introduction of automatic enrolment, therefore it is not straightforward to isolate the effect that automatic enrolment is having (or will have in future) on levelling down. The reduction in the generosity of pensions savings offers has been consistent in the private sector between 2006 and 2012, with around 6% of schemes reducing employer contributions between 2010 and 2012.[81]

Current data suggests that the majority of large employers have been automatically enrolling workers at the minimum required contribution level, though few employers have, or have said that they intend to, level down provision for workers who were scheme members before automatic enrolment began.[82]

The way that employers respond to automatic enrolment will affect the number of people saving in workplace pension schemes
This chapter uses scenario analysis to explore how different employer responses to automatic enrolment could affect the number of people saving into private sector workplace pension schemes and the value of private sector workplace pension assets (contributions plus investment growth over time). The following scenarios are explored:

- **The "minimum contributions" scenario –** a scenario which explores the impact of levelling down by all employers on behalf of all workers
- **The "existing trends" scenario–** a scenario which uses emerging data on the existing trends in employer behaviour to explore the impact of current behaviour continuing throughout the automatic enrolment process and in the future

[81] DWP (2013b) Pp. 74-76, para 4.3, para, 4.3.3 Figure 4.1
[82] DWP (2013b) p. 74, para 4.3.1

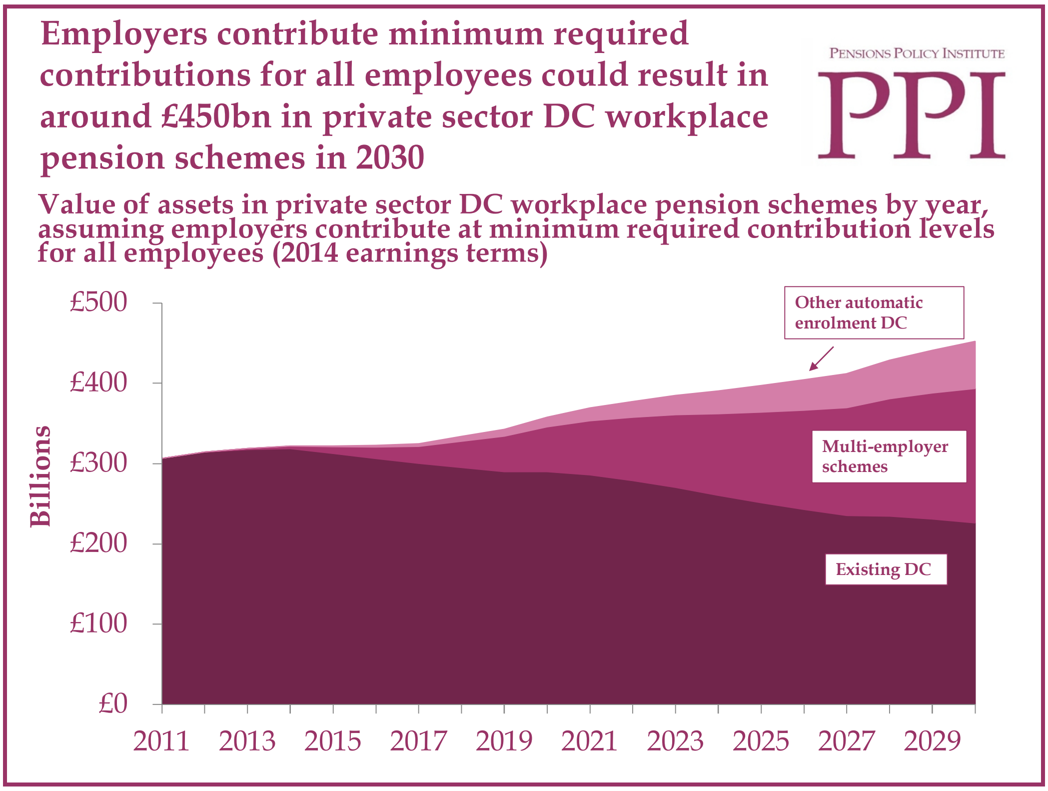
- **The "maintaining current provision" scenario** - a scenario which explores the impact of maintaining current provision and contribution levels for the workers of all employers with existing provision

The "minimum contributions" scenario
In order to illustrate the effect that levelling down by all employers on behalf of all workers could have on assets in private workplace pension schemes, the PPI modelled an extreme levelling down scenario, in which all employers automatically enrol their workers at minimum contribution levels and level down all existing provision to the minimum contribution level at their staging date.

If it is assumed that:

- Employers without existing provision automatically enrol new workers into automatic enrolment multi-employer schemes and pay the minimum required contribution level of 1% rising to 3% of band earnings (£5,772 to £41,865 in 2014/15).
- Employers with existing provision automatically enrol workers into existing provision, and pay minimum required contribution levels on behalf of both automatically enrolled and existing scheme members.
- 15% of workers opt out.
- Automatically enrolled and existing workers contribute at minimum required levels.

Chart 16[83]



Total assets

- **By 2018** there could be around £1,370 billion total assets (2014 earnings terms) in private sector workplace pension schemes
- **By 2030** there could be around £1,160 billion total assets in private sector workplace pension schemes

DC assets

- **By 2018** there could be around £335 billion DC assets (2014 earnings terms) in private sector workplace pension schemes
- **By 2030** there could be around £450 billion DC assets in private sector workplace pension schemes (Chart 16)

The "existing trends" scenario

The "existing trends" scenario uses emerging data on the broad existing trends in employer behaviour to model what the effect might be if current behaviour continued throughout the automatic enrolment process and in the future. Existing trends suggest that larger employers with existing provision are more likely to automatically enrol workers on existing terms, and that smaller employers with existing provision are more likely to level down provision for automatically enrolled workers. The existing trends scenario is constructed from data drawn from existing DWP data and scheme data on employer behaviour.

[83] PPI Aggregate Model

The technical annex contains a detailed breakdown of how the scenario assumptions were constructed.

If it is assumed that:

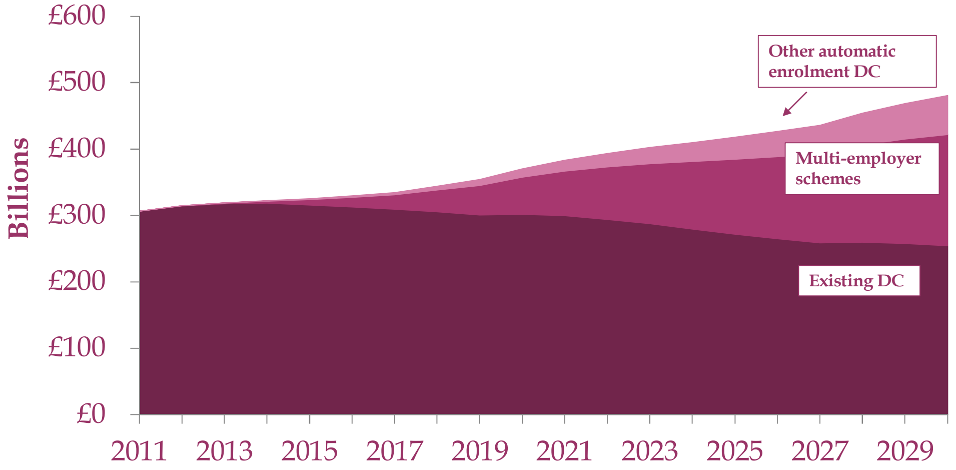
- Of newly automatically enrolled workers where employers have existing DC provision:
  - 80% are automatically enrolled at the minimum required contribution levels on total earnings into a new DC scheme set up for automatic enrolment
  - 20% are automatically enrolled at their employers existing contribution level
- Of existing members of DC workplace schemes:
  - 80% remain in their current scheme at current contribution levels
  - 20% are moved into a new, automatic enrolment DC scheme and have their contribution levels reduced to minimum required levels under automatic enrolment (on total earnings)
- All employers without existing provision automatically enrol new workers into automatic enrolment multi-employer schemes and pay the minimum required contribution level on band earnings.

Chart 17[84]

Employers continuing to contribute in line with existing trends could result in around £480bn in private sector DC workplace pension schemes in 2030

PENSIONS POLICY INSTITUTE PPI

Value of assets in private sector DC workplace pension schemes by year, assuming employers continue to contribute in line with existing trends (2014 earnings terms)



Total assets

- **By 2018** there could be around £1,380 billion total assets (2014 earnings terms) in private sector workplace pension schemes
- **By 2030** there could be around £1,180 billion total assets in private sector workplace pension schemes

DC assets

- **By 2018** there could be around £345 billion DC assets (2014 earnings terms) in private sector workplace pension schemes
- **By 2030** there could be around £480 billion DC assets in private sector workplace pension schemes (Chart 17), £30 billion more than under the "minimum contributions" scenario

The "maintaining current provision" scenario

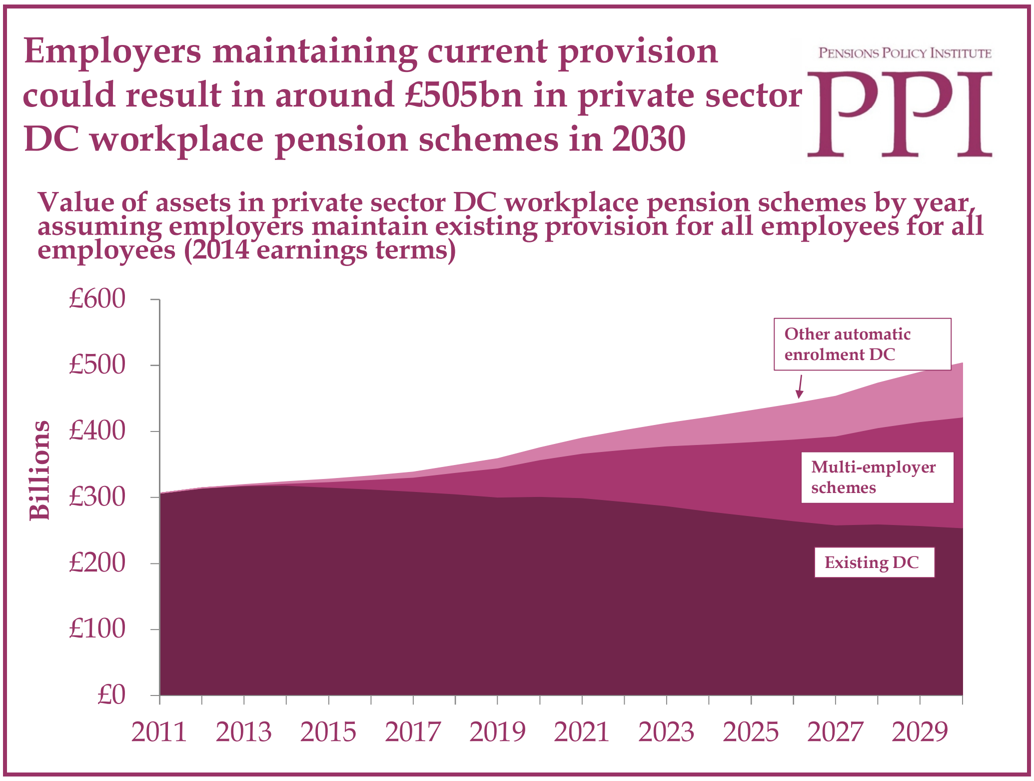
In order to illustrate the effect that maintaining current provision and contribution levels for the workers of all employers with existing provision could have on the level of assets in private workplace pension schemes, the PPI modelled a scenario, in which employers with existing provision maintain pre-automatic enrolment contribution levels for both existing members and automatically enrolled workers.

[84] PPI Aggregate Model

If it is assumed that:

- All employers without existing provision automatically enrol new workers into automatic enrolment multi-employer schemes and pay the minimum required contribution level. Automatically enrolled workers in automatic enrolment multi-employer schemes contribute at minimum required levels.
- All employers with existing provision automatically enrol workers into existing schemes, and pay pre automatic enrolment contribution levels on behalf of both automatically enrolled and existing scheme members (9% of gross earnings on average rising to 11% by 2030 to reflect higher compensation from employers who have replaced DB schemes).

Chart 18[85]



Total assets

- **By 2018** there could be around £1,390 billion total assets (2014 earnings terms) in private sector workplace pension schemes
- **By 2030** there could be around £1,210 total assets in private sector workplace pension schemes

DC assets

- **By 2018** there could be around £350 billion DC assets (2014 earnings terms) in private sector workplace pension schemes

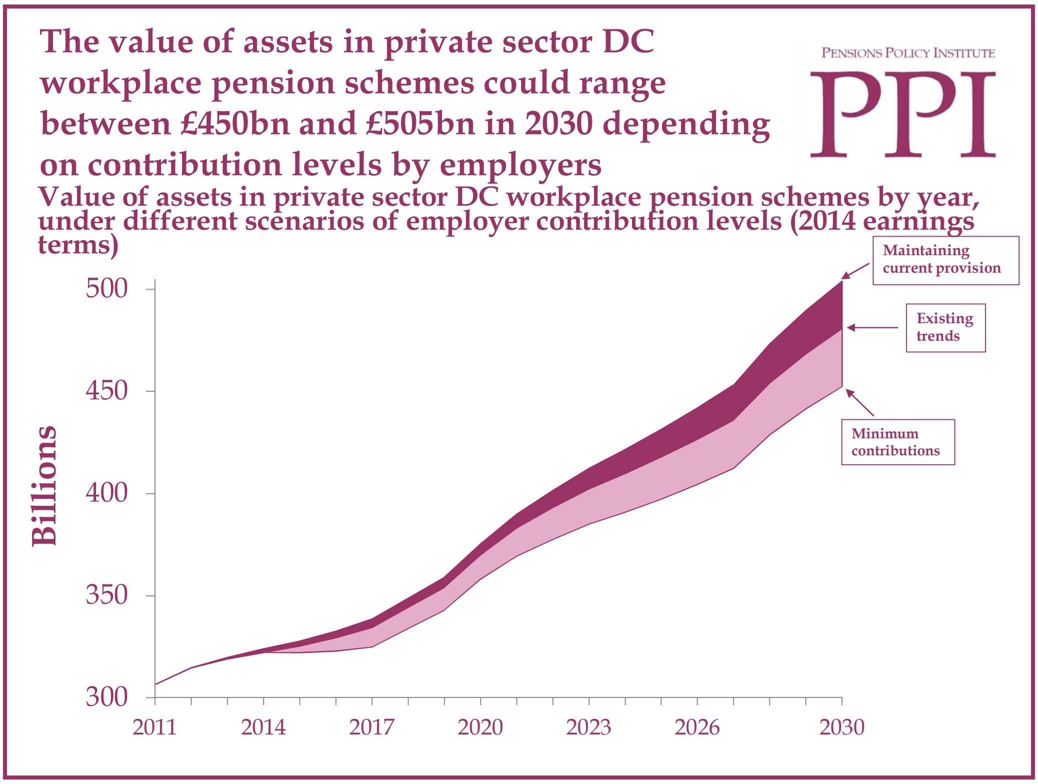
[85] PPI Aggregate Model

- **By 2030** there could be around £505 billion DC assets in private sector workplace pension schemes (Chart 18), £50 billion more than the "minimum current contributions" scenario and £25 billion more than under the "existing trends" scenario (figures may not total due to rounding)

The value of DC assets could range between £450 billion and £500 billion in 2030

This analysis indicates that, (assuming a range of employer responses to automatic enrolment and an average employee opt-out rate of 15%):

Chart 19[86]



- the value of assets in DC private sector workplace pension schemes in 2030 could range between £450 billion and £505 billion (2014 earnings terms) (Chart 19).

Chart 19 shows a narrow range of potential outcomes from the employer response scenarios in 2030, of around £55 billion. This is because all of the scenarios assume that a large proportion of those automatically enrolled (around two thirds of working population in 2030) receive minimum required contributions from their employer. This is line with the current behaviour of employers automatically enrolling, the expectations of those who have not yet automatically enrolled and the high proportion of workers who are in organisations with no current provision. The analysis assumes that those in schemes with no current provision are automatically enrolled into multi-

[86] PPI Aggregate Model

employer schemes. The analysis includes workers who become automatically enrolled as a result of starting new jobs.

Therefore, the range above explores what the impact of a range of scenarios could be on employees of those employers who had existing provision prior to automatic enrolment. The scenarios illustrate what could happen if these employees receive either minimum required contributions, contributions in line with existing trends in employer behaviour, or are levelled up to the contribution levels employers maintained before automatic enrolment.
The range would be wider if different assumptions were made for the entire working population and is also likely to widen over time.

Summary
This chapter uses data provided by three automatic-enrolment scheme providers (Legal & General, NEST and The People's Pension), one employee benefit consultant (JLT), and the DWP, to explore the potential effect of a reasonable range of contribution behaviour by employers on the value of assets in private sector DC workplace schemes.

The analysis indicates that, (assuming a range of employer responses to automatic enrolment and an average employee opt-out rate of 15%) the value of assets in DC private sector workplace pension schemes in 2030 could range between £450 billion and £505 billion (2014 earnings terms).

This report uses scenario analysis to explore how different employer and employee responses to automatic enrolment could affect the number of people saving into workplace pension schemes and the total value of private sector workplace pension assets.

The research found that that the vast majority of new private sector pension savers arising from automatic enrolment are likely to be saving in Defined Contribution (DC) workplace pension schemes. In the future, DC is likely to dominate in the private sector and the value of private sector DC assets could become greater than the total value of private sector workplace DB assets in around 2036.

The number of new savers and the value of private sector pension assets in future will depend to some extent on the decisions that employers and employees make in response to automatic enrolment. Though there is uncertainty about the future, opt-out rates are currently low at between 9-10% on average, and the majority of employers with existing provision are maintaining current contribution rates for existing scheme members.

The decisions made in future by small to medium sized employers and their workers will depend on many factors including employer decisions and engagement, and workers' perceptions regarding pension saving and affordability.

It is clear that many private sector workers will be reaching retirement with DC savings in the future. From April 2015, people will also have more flexibility in terms of accessing their DC savings. This means that both the nature of the pension savings people reach retirement with and the way people take and use this as income in retirement is also likely to look very different in future from how it does today.

Appendix 1: Modelling Assumptions

Overview of Aggregate Modelling of Private Pensions
The modelling in this report uses the PPI Aggregate Model, which links changes in the UK population, the labour market and economic assumptions to project forward private (and state) pension savings. Population projections are taken from 2012-based figures published by the ONS.

Current distributions of individuals across pension scheme types are taken from the Lifetime Labour Market Database (LLMDB)[87] a panel dataset of 1% of UK National Insurance records. The workforce data includes numbers of individuals and average earnings split by age, gender and earnings band. The data are also split between public and private sector contracted-out schemes and those who are contracted-in to the second state pension (S2P).

Initial Conditions
In the base year (2010), individuals with private sector pension arrangements are split between public and private Defined Benefit (DB) schemes and workplace Defined Contribution (DC) schemes. 17.5% of working individuals are assumed to be members of DC workplace pensions and 32.1% of individuals are assumed to be members of DB workplace schemes.[88] 73.2% of those in DB schemes are assumed to work within the public sector,[89] leaving 8.6% of the workforce in private sector workplace DB schemes.

The workforce not enrolled in public sector DB, private sector DB or private sector workplace DC, are considered as the eligible population for automatic enrolment. This includes individuals not in workplace pension schemes who contribute to personal pensions.

Stocks of existing assets for DB schemes and workplace DC schemes are split across cohorts by the likely contributions made. Initial stocks of workplace DB assets were assumed to be £890 billion in the base year[90]. It was assumed that the stocks of DC assets in 2010 were £275 billion[91].

Movement of individuals between schemes due to decline in DB schemes
The proportion of individuals in each scheme do not stay stable over time: the proportion of the total workforce who are enrolled in a private sector DB scheme is assumed to decline by 80% between 2010 and 2030 and these individuals are moved into the existing DC workplace schemes.

[87] Data from LLMDB 2010-11
[88] ONS (2013a)
[89] Average proportion of males and females employed in public sector COSR schemes according to LLMDB 2010-11
[90] TPR (2012) The Purple Book Chapter 4 Table 4.1 Assets discounted to the base year.
[91] Workplace DC assets taken from ONS (2012) Table 3, adjusted for decumulated assets.

Movement of individuals between schemes post automatic enrolment
From 2012, employees in the private sector without workplace DC provision are placed in a scheme to represent automatic enrolment multi-employer/master-trust schemes. Individuals are enrolled in proportion to the likely number of employees becoming eligible each year due to staging of their employers. Similarly, during the staging period, employees in existing DC schemes who become eligible for automatic enrolment either remain in the existing scheme or are moved to a new automatic enrolment workplace DC schemes. In the central 'existing trends' scenario used in Chapter 2, 80% of existing members are assumed to remain in the existing scheme, and 20% are expected to move to the new automatic enrolment scheme (see Appendix 3 for how these percentages were arrived at). New members to DC schemes who have an employer with an existing scheme either join the new automatic enrolment scheme (80%) or join an existing DC scheme (20%).

Overall, after 2012 the private sector workforce is assumed to contribute to either private sector DB pensions, workplace DC schemes which were existing prior to automatic enrolment, workplace DC which were set up for automatic enrolment, or multi-employer/master-trust schemes. It is assumed that 14%[92] of the workforce change jobs from year to year, which causes individuals to shift from existing DC workplace schemes into new DC automatic enrolment schemes over time.

Contributions
Contributions are taken as a percentage of total earnings for employer provided schemes (both existing schemes and those set up after automatic enrolment) and are taken across band earnings for individuals automatically enrolled into multi-employer/master-trust schemes. The earning band is taken to be £5,772 to £41,865 with an earnings trigger of £10,000 (all in 2014/15 terms).

When automatically enrolled, individuals and their employers are assumed to contribute at the minimum levels required under automatic enrolment legislation (phased in from a combined contribution of 2% of band salary in 2012, rising to 8% of band salary in 2018 in accordance with existing regulations) unless otherwise stated.

General assumptions
Nominal average investment returns across all asset classes are assumed to be 6% based on overall investment returns on a fund with 67% invested in equities. These assumptions are consistent with those used across the PPI modelling suite and are the result of consultation with the PPI's modelling review board, which consists of a number of experts in the field of financial modelling.

[92] Average annual workforce churn. DWP (2010) p49

Charges are assumed to be 0.75% for existing workplace DC schemes,[93] and 0.5% for multi-employer/master-trust schemes set up for automatic enrolment.[94]

Long-term earnings growth is set to 4.4% in line with Office of Budget Responsibility (OBR) assumptions[95]. The earnings band for automatic enrolment contributions and minimum salary assumption are assumed to grow with average earnings.

93 Average charges for trust-based schemes are 0.71% and for contract-based schemes 0.95%, DWP (2012b), and a 0.75% charge cap will be introduced for any DC default funds being used for automatic enrolment from April 2015 onwards.
94 Equivalent Annual Management Charge for multi-employer/Mastertrust schemes such as Legal and General's Worksave, NEST and The People's Pension.
95 OBR (2013)

Appendix 2: Alternative Model Runs

Sensitivity to assumptions of gradual DB decline

While in the report we have assumed that membership of private sector DB schemes will decline by 80% between 2010 and 2030, the abolition of contracting-out in 2016 (alongside the introduction of the single-tier state pension) may trigger employers to consider closing their DB schemes immediately due to increased costs and the need to restructure the scheme as a result of losing the contracted-out rebate. In addition, while it is unclear what effect the Chancellor's Budget announcements in March 2014 will have on the DB market, and while a decision is yet to be made on whether individuals will be able to transfer out of DB schemes into DC schemes under the proposed changes, it is possible that the increased flexibility at retirement now offered by DC schemes will make DC schemes more attractive to private sector employers and individuals in future. We have therefore modelled an alternative fast decline scenario where membership of private sector DB schemes declines by 80% in 2016.

Chart A1 shows that *without automatic enrolment* the DB and DC assets are expected to total £990bn in 2030 (of which £370bn is in workplace DC schemes) if there is a fast decline in DB in 2016; slightly below the total £1050bn assets expected when private sector DB is assumed to decline smoothly until 2030 (of which £350bn is in workplace DC schemes). Similarly, *with automatic enrolment,* overall assets saved in DC schemes are higher under a 15% opt-out scenario with a faster reduction in DB membership, totalling £500bn in 2030 (Chart A2), in contrast to £480bn when a smooth decline is assumed. The overall increase in assets in DC schemes compared to the no automatic enrolment baseline is expected to be the same for both fast decline and smooth decline options, at £130bn by 2030.

Chart A1[96]

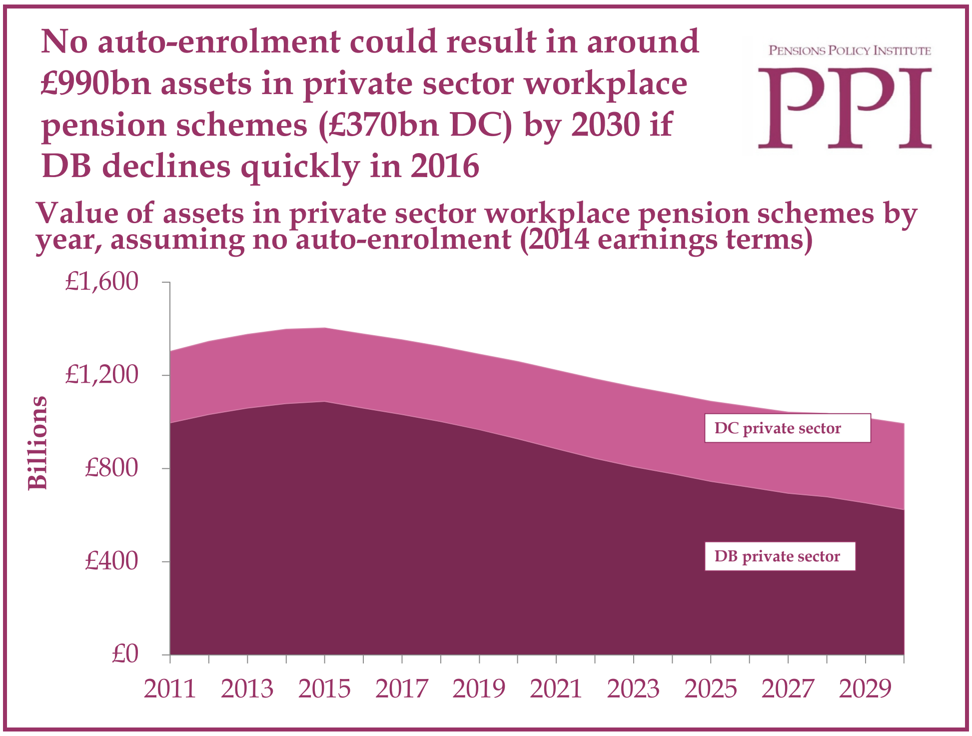
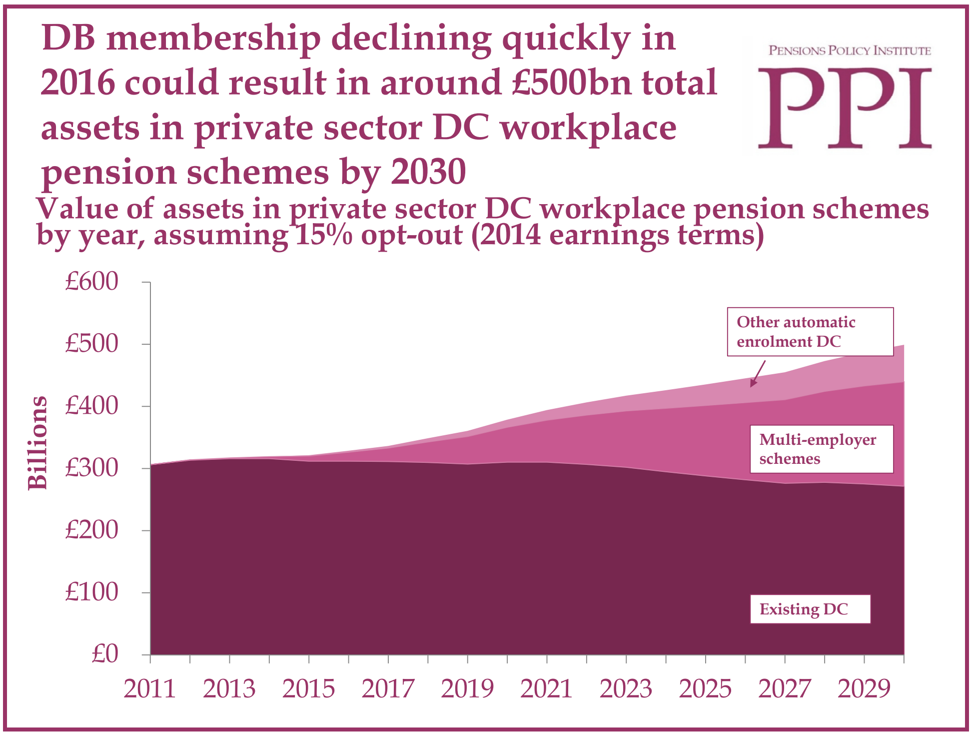


Chart A2[97]



[96] PPI Aggregate Model
[97] PPI Aggregate Model

Sensitivity to investment assumptions
Investment returns may in reality be higher or lower than the assumed average investment return of 6%. Flexibility at retirement and during the decumulation period, initiated by the Budget changes announced in March 2014, could led to a greater overall proportion of assets invested in equities than funds do currently and thus a higher overall return (for example, if glide-paths in DC default funds lo longer target as high a proportion of assets towards bonds in the later years of working life to hedge against annuity movements). Conversely, investment growth is dependent on the economic climate, and poorer investment conditions than expected may lead to average investment returns of lower than 6%. In light of prevailing economic conditions the FCA's Conduct of Business Sourcebook reduced the intermediate rate of return used in standardised deterministic projections used in key features documents for DC pension schemes to 5% in 2014 (from 7%).[98] Alternative average investment return assumptions of 5% and 7%, and their impact on total DC assets, is illustrated in Charts A3 and A4 below.

Chart A3 shows that with a 7% overall investment return the total assets in 2030 could be around £535bn, this is around 11% higher than the total assets of £480bn in our central scenario. A 5% investment return would lead to total assets in workplace DC of around £435bn, around 11% lower than under the central scenario.

Comparing all opt-out rates at 5% investment returns; total workplace DC assets in 2030 range between £410bn if 25% of employees opt out of automatic enrolment and £450bn if the proportion of employees opting out of automatic enrolment remains at 9%.

[98] FCA (2014)

Chart A3[99]

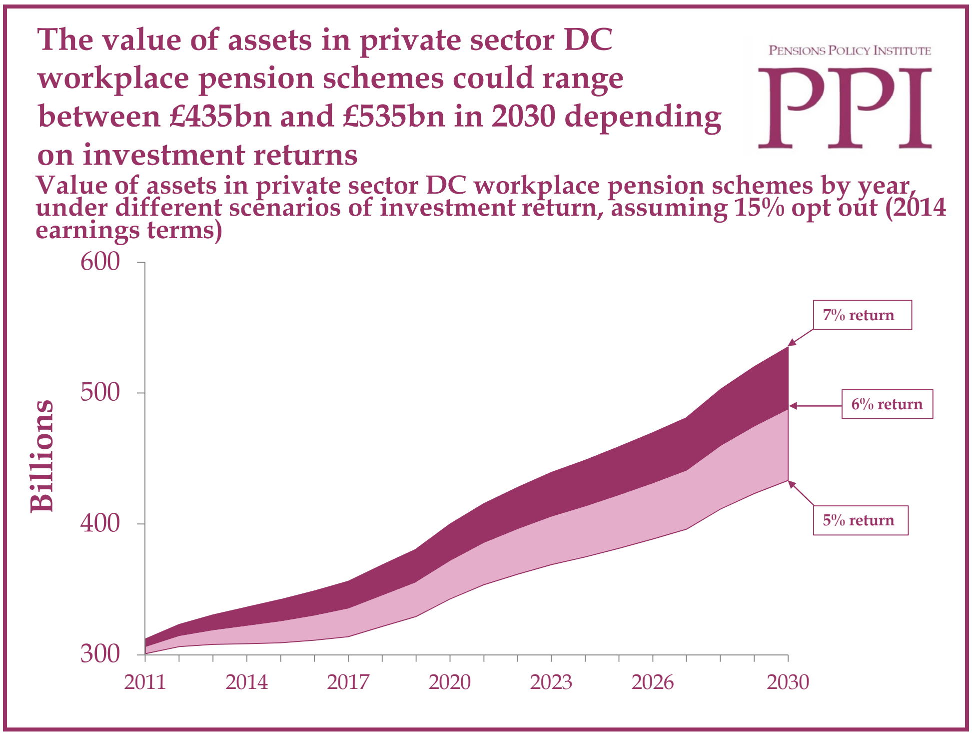
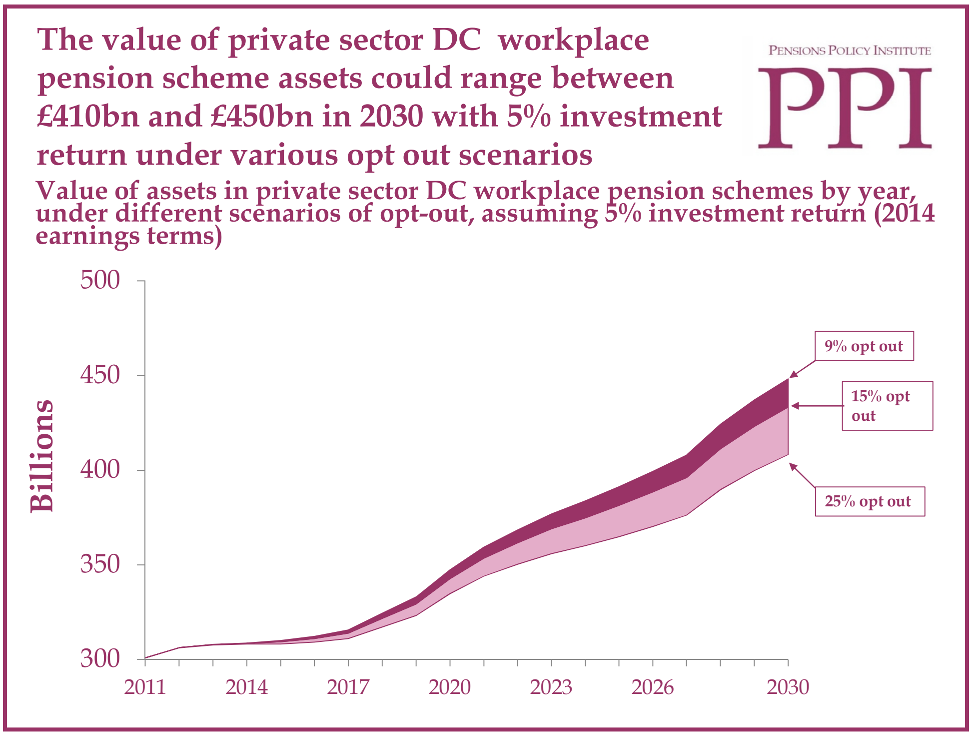


Chart A4[100]



[99] PPI Aggregate Model
[100] PPI Aggregate Model

Appendix 3: Analysis of Providers' Data

Employee response - information compiled on opt-out rates from providers and consultants

Three of the major automatic enrolment providers (Legal and General, NEST and the People's Pension) and one employee benefit consultant (JLT) shared data from their experiences of implementing automatic enrolment, covering over 2.6 million of the individuals who have been automatically enrolled. The data from Legal and General's WorkSave range included their enrolments for 2013, while the data from other sources typically covered from the introduction of automatic enrolment in October 2012 until spring 2014 (either end of April or May). It therefore reflects the opt-out experience of the larger employers who have reached their staging dates during that time, e.g. employers with more than 250 employees had reached their staging dates by 1st February 2014 and would need to have automatically enrolled their workers within the following three months.

The following trends were identified from the data on the experience of larger employers:

- Opt-out rates experienced by men and women are similar but consistently slightly higher overall for women (at 7-8% for women compared to 6-7% for men).

- Opt-out rates vary by age and are consistently highest for the older age-groups (typically around 4-6% for those in their twenties and thirties, rising to 5-7% for those in their forties, 9-15% for those in their fifties, and as high as 20-30% for those in their early sixties). Data collected directly from employers in the Employers' Pension Provision Survey 2014 also suggested higher opt-out rates amongst older workers[101].

- While opt-out rates for individuals younger than 22 and older than 65 were observed by providers and consultants (for example, where an employer has chosen to enrol groups of workers beyond the minimum statutory requirements of 22 to State Pension Age (SPA)) the smaller number of individuals in these age groups make the average opt-out rates less robust. Generally though the opt-out rates for those younger than 22 were still relatively low, and below 6% on average across all providers.

- There is some tentative evidence that employee opt-out rates are higher when the initial employee contribution is set higher. For example, the data from one source showed that for those with employee contribution rates of 3% or higher there was an average opt-out rate of around 25%, compared to an average opt-out rate of 8% for those with employee contribution rates below 3%.

[101] DWP (2014a)

- However, investigation of other data received suggests that opt-out rates can also vary considerably between employers, between different groups of workers *within* an employer, and by the employers own contribution rate. Therefore it is not possible to draw any strong conclusions on the relationship between the employee contribution rate and opt-out rates.

Given the timing of the field work for the DWP's Employers' Pension Provision (EPP) survey only around 2% of the employers interviewed had passed the staging date, and these were large employers (500 to 4000 employees). Therefore these data are used to guide the assumptions used in the central, low and high opt-out rate scenarios in Chapter 2, but with thought to how the implementation experience may change as the smaller employers reach their staging dates and as phasing rolls out and minimum employee contributions increase.

Employer response – information compiled on the expected employer response from the Employers' Pension Provision (EPP) Survey and other sources

Data collected in the EPP Survey[102] has been used to inform the assumptions about the likely employer response, in terms of the type of scheme to be used for automatic enrolment for existing and new members, and the expected level of contributions for existing and new members.

This data has been combined with data from other sources, including the Business Population Estimates[103], the Annual Survey of Hours and Earnings[104] and previous estimates of the population expected to be eligible for automatic enrolment by employer size[105].

The fieldwork for the EPP Survey took place between June 2013 and November 2013 so is expected to have captured employers with over 4000 employees (those reaching staging dates in June 2013) and over 500 employees (those reaching staging dates in November 2013). Summarised below are the key findings in the EPP Survey that have informed the assumptions for the "existing trends" employer response scenario used in Chapter 3 and the "existing trends" scenario which was used as the employer response baseline for the opt-out scenarios in Chapter 2.

<u>For existing members of workplace pension schemes</u>

- 65% of the larger (already staged) employers who had begun automatic enrolment already had a workplace pension scheme in place at the start of the reforms.

[102] DWP (2014a)
[103] Department for Business, Innovation and Skills - Business population estimates 2013, www.gov.uk/government/publications/business-population-estimates-2013
[104] Annual Survey of Hours and Earnings Pension Tables
[105] DWP (2010)

- The vast majority of these employers (94%) had chosen to retain existing members within that scheme rather than enrolling them into a new qualifying scheme. The vast majority (92%) had also chosen not to alter their contribution rate.

- For these purposes we have assumed that 6% of existing members with a larger employer are "levelled down" to the minimum contributions in a new scheme set up for automatic enrolment.

- For the smaller (not yet staged) employers only 12% already had members in a workplace pension scheme in place at the start of the reforms.

    - Again the majority of those employers (59%) said they would retain existing members within that scheme rather than enrolling them into a new qualifying scheme. However, there was considerable uncertainty with 24% remaining undecided.

    - For these purposes we have assumed that 41% of existing members with a smaller employer are "levelled down" to the minimum contributions in a new scheme set up for automatic enrolment.

- **When combined with data from the Business Population Estimates 2013 (BIS, on employment by size of employer) and the Annual Survey of Hours and Earnings 2013 (ONS, on the proportion of employees in the private sector who are members of a workplace pension scheme by size of employer) we generate a central assumption that 80% of existing members will remain in their current scheme at current contribution levels and 20% will be "levelled down" in a new scheme set up for automatic enrolment.**

- The preliminary findings from the EPP Survey for 2013 are broadly consistent with earlier EPP survey data[106].

<u>For non-members and new employees</u>:

- 65% of the larger (already staged) employers who had begun automatic enrolment already had a workplace pension scheme in place at the start of the reforms.

[106] DWP (2012d)

- The majority of these employers (74%) said they would enrol non-members and new employees within that scheme rather than enrolling them into a new qualifying scheme.

- For these purposes we have assumed that the other 26% of non-members and new employees with a larger employer are "levelled down" to the minimum contributions in a new scheme set up for automatic enrolment.

- For the smaller (not yet staged) employers only 12% already had members in a workplace pension scheme in place at the start of the reforms.

- The minority of those employers (24%) said they would retain existing members within that scheme rather than enrolling them into a new qualifying scheme. However, there was considerable uncertainty with 43% remaining undecided.

- For these purposes we have assumed that 76% of existing members with a smaller employer are "levelled down" to the minimum contributions in a new scheme set up for automatic enrolment.

- **When combined with data from the DWP's Making Automatic Enrolment Work Review 2010 (on the number of workers expected to be eligible for automatic enrolment by employer size) we generate a central assumption that 20% of non-members and new employees will be placed in an existing scheme at current contribution levels and 80% of non-members and new employees will be placed in a new scheme set up for automatic enrolment.**

- The preliminary findings from the DWP's Employer's Pension Provision Survey 2013 are broadly consistent with the results of other recent surveys on automatic enrolment.

- For example, the NAPF's latest Annual Survey[107] found that 68% of employers would be using an existing DC scheme and 10% an existing DB or hybrid scheme for automatic enrolment. Similarly, a survey carried out by Aon Hewitt in the autumn of 2012[108] found that 66% of employers were giving non-members access to an existing DC scheme and 5% to an existing DB scheme.

[107] NAPF (2013)
[108] Aon Hewitt (2013)

- The ACA's 2013 Pension Trends Survey[109] found that only 22% of employers expected to restrict non-members and new employees to a lower-cost scheme sponsored by the firm or a multi-employer scheme or NEST with their existing members remaining in the current scheme. The ACA's 2011 Pension Trends Survey[110] had also previously found that 73% of employers with an existing DB or DC scheme would automatically enrol non-members into their existing scheme.

[109] ACA (2013)
[110] ACA (2011)

Acknowledgements and Contact Details

The Pensions Policy Institute is grateful for input from many people in support of this paper, including:

Amra Adam	Peter Cottingham	Timothy Fassam
John Adams	Chris Curry	Maritha Lightbourne
Rosy Anand	Philip Doggart	Darren Philp
Adrian Boulding	Melissa Echalier	Will Sandbrook
Nick Campbell	Andrew Evans	Andrew Seed
Simon Chinnery	Martin Freeman	Richenda Solon

Editing decisions remained with the author who takes responsibility for any remaining errors or omissions.

The Pensions Policy Institute is an educational charity promoting the study of retirement income provision through research, analysis, discussion and publication. The PPI takes an independent view across the entire pensions system.

This report uses outputs from the PPI's Suite of Models that have been developed under grants from the Nuffield Foundation. Data which fed into underlying assumptions was provided by Legal & General, NEST and The People's Pension, JLT, and the DWP. The PPI is grateful to these organisations for providing this data. These providers take no responsibility for the content of this report.

The PPI is funded by donations, grants and benefits-in-kind from a range of organisations, as well as being commissioned for research projects. To learn more about the PPI, see: www.pensionspolicyinstitute.org.uk

Contact:
Chris Curry, Director
Telephone: 020 7848 3744
Email: info@pensionspolicyinstitute.org.uk

Pensions Policy Institute
King's College
26 Drury Lane
London WC2B 5RL

The PPI is grateful for the continuing support of its Platinum & Gold members:

Platinum	Gold
JLT	AXA Investment Managers
Just Retirement	BlackRock
J.P. Morgan Asset Management	Capita
The Pensions Regulator	Department for Work and Pensions
Prudential UK & Europe	Hymans Robertson
Threadneedle Investments	The People's Pension
	RPMI

A full list of supporting members is on the PPI's website.

References

Aon Hewitt (2013) *Auto-enrolment: Summary of Aon Hewitt's Autumn 2012 survey*

Association of British Insurers (ABI) (2013) *The UK Annuity Market: Facts and Figures 2013*

Association of Consulting Actuaries (ACA) (2013) *Pension trends survey*

Association of Consulting Actuaries (ACA) (2011) *Pension trends survey*

Department for Work and Pensions (DWP) (2014a) *Employers' Pension Provision Survey 2013: Preliminary findings*

Department for Work and Pensions (DWP) (2014b) *Better workplace pensions: Further measures for savers*

Department for Work and Pensions (DWP) (2014c) *Landscape and Charges Survey 2013: Charges and quality in defined contribution pension schemes*

Department for Work and Pensions (DWP) (2013a) *Automatic enrolment opt out rates: findings from research with large employers*

Department for Work and Pensions (DWP) (2013b) *Automatic Enrolment evaluation report 2013*

Department for Work and Pensions (DWP) (2013c) *Review of the automatic enrolment earnings trigger and qualifying earnings band for 2014/15: supporting analysis*

Department for Work and Pensions (DWP) (2012a) *Workplace Pension Reform: digest of key analysis*

Department for Work and Pensions (DWP) (2012b) *Pension landscape and charging: Quantitative and qualitative research with employers and pension providers; Research Summary*

Department for Work and Pensions (DWP) (2012c) *Reinvigorating workplace pensions*

Department for Work and Pensions (DWP) (2012d) *Employers' Pension Provision Survey 2011*

Department for Work and Pensions (DWP) (2010) *Making automatic enrolment work: A review for the Department for Work and Pensions*

Department for Work and Pensions (DWP) (2006) *Self-employment and retirement*

Financial Conduct Authority (FCA) (2014) *COBS 13 Annex 2 Projection* fshandbook.info/FS/print/handbook/COBS/13/Annex2

National Association of Pension Funds (NAPF) (2013) *NAPF Annual Survey 2013* (NAPF) www.napf.co.uk

National Employment Savings Trust (NEST) (2013) *Looking after members' money*

National Employment Savings Trust (NEST) (2012) *Member Research Brief*

Office of Budget Responsibility (OBR) (2013) *Fiscal sustainability report, July 2013*

Office of Fair-Trading (OFT) (2013) *Defined Contribution Workplace Pension Market Study*

Office for National Statistics (ONS) (2013a) *Pension Trends – Chapter 7: Private Pension Scheme Membership, 2013 Edition*

Office for National Statistics (ONS) (2013b) *Pension Trends Chapter 8: Pension Contributions, 2013 edition*

Office for National Statistics (ONS) (2012) *A Fuller Picture of the UK's Funded and Unfunded Pension Obligations*

The Pensions Policy Institute (PPI) (2014) *Freedom and Choice in Pensions: the minimum pension age*

The Pensions Policy Institute (PPI) (2012) *Closing the gap: the choices and factors that can affect private pension income in retirement*

The Pensions Regulator (TPR) (2014) *Detailed guidance for employers. Chapter 2: Getting ready: First steps to prepare for the new employer duties*

The Pensions Regulator (TPR) (2013) *The Purple Book*

The Strategic Society Centre (SSC) Institute for Social & Economic Research (ISER) (2014) *Who Saves for Retirement? 2: Eligible non-savers*

Published by
PENSIONS POLICY INSTITUTE

PPI

www.pensionspolicyinstitute.org.uk
ISBN 978-1-906284-29-9