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Will Personal Accounts increase pension saving?

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Introduction

This paper illustrates the potential impact of the Government's three key reform proposals for work-based pension saving in the UK. These reforms are:

- Auto enrolment into work-based pension schemes for eligible employees.
- The introduction of compulsory employer contributions for employees who remain opted in to work-based saving.
- The introduction of a new national pensions savings scheme, called Personal Accounts.

This paper uses scenarios that illustrate the potential combined impact of the three reforms on the assumption that individuals and employers act in certain ways. Scenarios are useful to answer 'what if?' type questions. However, the scenarios are deliberately stylised and, as such, no judgement is made on their likelihood.

Chapter 1 explores the impact of different participation rates on the additional number of people saving for a pension as a result of the reforms. This relates both to the decisions of employees to remain in or to opt out of work-based saving and other individuals' decisions to join. This chapter also discusses some policy options that could influence participation.

Chapter 2 explores the impact of employers' behaviour on annual total pension contributions. We focus here on contribution levels and use scenarios for how employers might maintain or reduce their current contribution levels.

Chapter 3 explores the impact of demand for the Personal Accounts scheme on the shape of the private pension market. We explore the aggregate size of pension funds under management and how this could be split between Personal Accounts and existing provision.

Chapter 4 discusses the policy implications and the design choices that may influence the likelihood of the Government meeting its policy objectives.

This discussion paper forms the background for a seminar to be held in November 2007. It has been funded by the Nuffield Foundation, and the PPI is grateful for its support.

This paper is the third in a series produced by the Pensions Policy Institute (PPI) that focus on outstanding issues in Personal Accounts. The two earlier papers in the series have examined different charging structures for Personal Accounts and the roles and objectives of the Personal Accounts Delivery Authority and Board.

Box 1 describes the Government's proposals in more detail.

Box 1: The Government's reform proposals

Overcoming inertia: Auto enrolment for eligible employees

- The Government has proposed that ***individuals will be automatically enrolled into qualifying work-based pension schemes or Personal Accounts if they are workers*** [employees] ***aged between 22 and State Pension age, and earning above approximately £5,000 a year.***
- Employees who earn below £5,000 a year or who are aged under 22 or over state pension age will not be eligible for auto enrolment, and neither will the self-employed or non-workers. These people will be able to choose to join Personal Accounts on a voluntary opt in basis.

Increasing incentives: Employer contribution and Government tax relief

- The Government has proposed that ***contributions will be made on a band of earnings by those earning between around £5,000 and £33,500 a year, the Personal Accounts earnings band, which will be uprated in line with earnings.***
- There will be a minimum combined contribution level of 8% of band earnings for employees. This will comprise 4% from the individual, a minimum of 3% from the employer, and at least 1% from the state through tax relief.
- Contributions will be phased in over three years, at: 1%, 3%, and then 5% for individuals (including tax relief); and, 1%, 2%, and then 3% for employers.
- Employees aged below 22 could choose to opt in to Personal Accounts on a voluntary basis and receive an employer contribution. Employees earning less than £5,000 a year could also choose to opt in and would receive tax relief on their savings, but there will be no requirement for an employer contribution to be payable.

Widening access: Introduction of the Personal Accounts scheme

- The Government proposes to introduce ***low cost Personal Accounts to give those without access to occupational pension schemes the opportunity to save.***
- The Personal Accounts scheme is a national scheme that is targeted at ***moderate to low earners without access to good pension provision.***

Summary of conclusions

The Government is introducing legislation that will mean that most employees will be auto enrolled into a work-based pension scheme from 2012 with an option to opt out. Employers will have the choice of auto enrolling their employees into an existing pension scheme or into a new national system of Personal Accounts. Under the proposals, employees who remain opted in to saving would contribute at least 4% of a band of earnings to the scheme. Employers will be required, for the first time, to contribute at least 3% of band earnings for employees who remain opted in. The Government will also contribute at least 1% through tax relief.

The principle of auto enrolment has been broadly supported as a way of overcoming inertia and increasing the number of people who save for their retirement. However, two concerns have been expressed. The first is that pension saving may not be suitable for all of the employees who are auto enrolled. The second, which is explored in this paper, is that employers might reduce or 'level down' their pension contributions in response to the increased costs they may face from the reforms.

The number of people saving for a pension

The reforms are likely to increase the number of people saving in a pension. However, levels of opt out remain uncertain, since the UK would only be the second country to introduce a national system of auto enrolment. The reforms could result in at least 4-5 million new savers in work-based pension schemes and possibly up to 9 million. These people will not all be new savers, since some of them will have previously been saving in a non work-based pension or in non-pension forms of saving, but many would benefit from the proposed compulsory employer contribution.

Higher participation in pension saving may mean that people are more likely to have an adequate income when they come to retire. However, there are also concerns that pension saving might not be suitable for everybody who is auto enrolled. This might be because the individual is likely to receive a low return on their saving or because the pension contributions are unaffordable or the individual has significant amounts of personal debt. These concerns may mean that very high levels of participation may not necessarily be the best outcome for the reforms.

Annual total pension contributions

The future level of annual pension contributions is uncertain even without the Government's reform. Defined Benefit pension provision has already been declining in the private sector but there is not a consensus view among pension experts about the future of this type of provision. Contributions into Defined Contribution schemes, although growing, are also uncertain.

To analyse the possible outcomes of the reforms on annual pension contributions, this paper uses a baseline scenario for what could happen without reform. This shows annual total pension contributions falling from around £40 billion in 2006 to around £30 billion by 2050, relative to national average earnings.

The reforms will increase the costs of pension provision for most employers. This is because of the higher levels of participation in pension schemes that is likely to result from the requirement on employers to automatically enrol their employees into pension saving and because of the requirement to contribute at least 3% for employees who remain opted in. Currently, only around 15% of private sector employers offer schemes that are more generous than the 3% minimum contribution.

Employers may be able to pass on increased costs in a variety of ways, for example, to consumers through higher prices, to workers through lower wage increases, or to shareholders or owners through lower profits. However, employers who already contribute more than 3% of band earnings could decide to reduce their contributions as a way of meeting the cost of the reforms.

This paper uses four stylised scenarios to explore the possible implications of employers responding in different ways. Evidence on likely employer responses is limited, so the scenarios seek to illustrate the potential impact of a range of scenarios, rather than imply that any of the scenarios is more likely to occur. All of the scenarios are based on an overnight introduction of the reforms in 2012. In reality the Government intends to phase in the compulsory employer contribution over a three-year period at the rate of 1% each year.

The reforms could increase annual total pension contributions, although employer responses will be very important in determining the total impact of the reforms on pension saving:

- If no employer decides to pass on the costs of the reforms by reducing their pension contributions, the reforms could increase annual total pension contributions (made by individuals, employers and the state combined) by around £10 billion in 2012 compared to without reform.
- Even if all of the employers who can reduce their pension contributions to hold their pension costs constant do so, the reforms could still increase annual total pension contributions by around £5 billion in 2012 compared to without reform. This is because employers who do not already offer the minimum 3% contribution to employees in work-based schemes will be compelled to do so under the reforms.
- If employers act in line with a survey of their likely responses, the reforms could increase annual total pension contributions by around £10 billion in 2012 compared to without reform. However, some employers have said they will close their existing schemes or reduce

their pension contributions as a result of the reforms. The reforms could still increase annual total pension contributions in 2050 but by less than £2.5 billion compared to without reform.
- It is important that employers continue to offer more than the 3% minimum contribution. In the extreme situation where no employer offers more than the minimum, annual total pension contributions could be £10 billion lower in 2050 than without reform.

Although annual total pension contributions would be higher than without reform under most of the scenarios, there would also be around 7 million more savers in work-based pension schemes.

Although surveys of likely employer responses have been conducted, they cannot predict with certainty how employers will act five years in advance of the reforms being introduced. Given the significant impact that employer behaviour will have on the outcome of the reforms, it will be important to continue to build the evidence base on employer responses in the period leading up to the introduction of the reforms.

The shape of the pensions market
Employers will have the choice of auto enrolling their employees into an existing pension scheme or into a new national system of Personal Accounts. Their decisions will affect the shape of the pensions market and the split of the market between existing types of work-based pension provision and the new Personal Accounts.

If employers decide to auto enrol their employees into existing schemes on existing terms, then the reforms could increase annual pension contributions to existing provision. This could benefit the current pensions industry. However, the bulk of the new contributions could be made from employers who do not currently offer a work-based pension scheme, and their employees. If these employers decide to use Personal Accounts, then the majority of the increase in annual total pension contributions as a result of the reforms could be to Personal Accounts rather than to existing types of pension provision.

If employers choose to close their existing schemes as a result of the increased costs that they face from the reforms, then annual pension contributions into existing types of pension provision may be lower than without reform. This could lead to a reduction in the size of the existing pensions market compared to without the reforms.

It will be important for the success of the reforms that employers offer more than the 3% minimum contribution. If employers only offered the 3% minimum, then the aggregate size of pension funds under management in existing types of pension provision might still grow over time, but may not keep pace with growth in national average earnings.

The aggregate size of pension funds in Personal Accounts could grow to reach significant levels by 2050. Organisations in the private sector will be used to manage these funds as well as administer them. This means that the reforms could provide a range of opportunities for the private sector.

Policy implications and design choices

The Government has said that its reforms aim to increase the number of people saving for a pension and for Personal Accounts to complement, rather than compete with, existing good-quality pension provision. There is the potential for the reforms to achieve both of these objectives. However, there can be tensions between the two objectives. Some policy options may contribute positively to both but most involve a trade-off between the two.

The analysis shows that employers' responses to the introduction of the reforms will be critical in determining the overall impact that the reforms have on the level of pension saving.

Chapter 1: Participation and the number of people saving for a pension

The reforms are likely to increase the number of people saving in a pension. However, levels of opt out remain uncertain, since the UK will be only the second country to introduce a national system of auto enrolment with the option for the individual to opt out.

This chapter shows that the reforms could result in at least 4-5 million new savers in work-based pension schemes and possibly up to 9 million. These people will not all be new savers, since some of them will have previously been saving in a non work-based pension or in non-pension forms of saving, but many would benefit from the proposed compulsory employer contribution.

Higher participation in pension saving may mean that people are more likely to have an adequate income when they come to retire. However, there are also concerns that pension saving might not be suitable for everybody who is auto enrolled. This might be because the individual is likely to receive a low return on their saving or because the pension contributions are unaffordable or the individual has significant amounts of personal debt. These concerns may mean that very high levels of participation may not necessarily be the best outcome for the reforms.

Auto enrolment and participation

The Government has sought to overcome inertia and procrastination[1] through auto enrolling employees into a Personal Account, or an equivalent pension scheme, with the option to opt out. However, there are a number of reasons why people choose not to save, and auto enrolment alone will not address all of the barriers to saving that people experience. Affordability concerns, lack of trust in providers, and other personal circumstances feature highly among reasons given by non-savers.[2] If, for example, affordability is the main reason why people do not save in a pension, this is not addressed simply by introducing a requirement for auto enrolment. In addition, some stakeholders have expressed concern that Personal Accounts might not be suitable for all of the employees who are auto enrolled.

Individuals who have been auto enrolled into pension saving will have a choice: they can either remain in the scheme (and continue to contribute 4% of their band earnings and receive a contribution of 3% of band earnings from their employer and a contribution of at least 1% of band earnings from the Government in tax relief) or they can decide to opt out

[1] See The Pensions Commission 2005 for evidence of procrastination and inertia being reasons for people putting off saving.
[2] ABI 2007 p 10

and cease to contribute. It is difficult to predict how many people will decide to opt out of pension saving.

In addition, a number of people who are not eligible for auto enrolment will be able to opt in to Personal Accounts on a voluntary basis. This could include people who do not earn more than £5,000 a year, people who are aged under 22, or people who are not employees, such as the self-employed. The decisions that these individuals make about whether they save in a pension, or not, will also affect the number of additional savers that result from the reforms.

The potential numbers of additional savers

The Government estimates that around 6 million employees were saving in a 'work-based pension scheme'[3] in the private sector in 2004/5. This includes around 4 million private sector employees receiving an employer contribution of more than 3% and around 2 million private sector employees who received an employer contribution of less than 3%. Around 6 million public sector workers will not be subject to the reforms so they are excluded from this analysis (Figure 1).

The reforms could benefit four different groups of people in different ways:

- Around 2 million employees who currently receive an employer contribution of less than 3% may benefit from the reforms by having their employer pension contribution increased to 3%.[4]
- Around 9 million employees were not saving in a work-based pension scheme at all in 2004/5 and would be eligible for auto enrolment, either into an existing type of work-based pension scheme or into a Personal Account.[5] Some of these individuals may choose to opt out of saving. Those who remain opted in could benefit from saving in a work-based pension scheme with an employer contribution of at least 3%.
- Around 3.5 million employees were not saving in a work-based pension scheme but would not be eligible for auto enrolment when the reforms are introduced because they do not earn more than £5,000 a year or because they are aged under 22. These individuals could choose to opt in to Personal Accounts on a voluntarily basis. Employees aged under 22 would benefit from an employer contribution of at least 3% if they opt in but people earning less than £5,000 would not.
- There are also around 3 million self-employed people and around 9 million economically inactive who will not be eligible for auto-

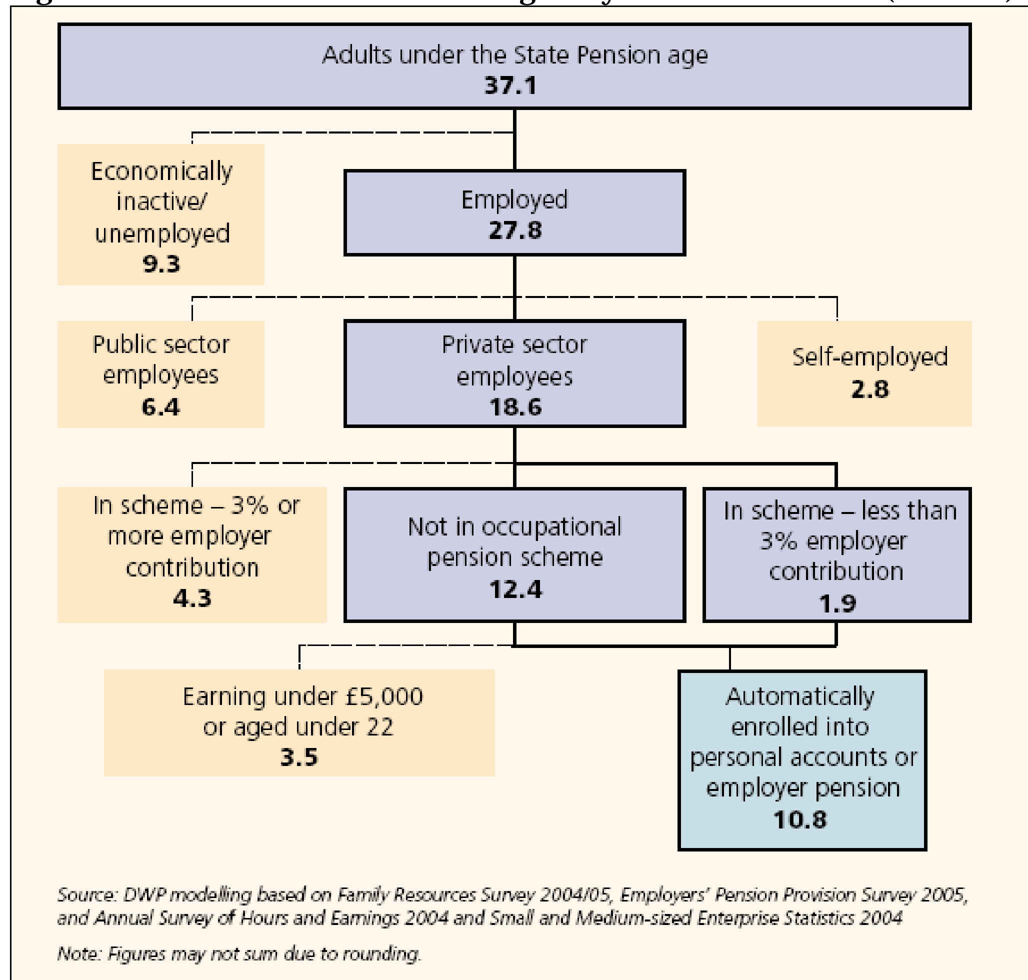
[3] In this paper, 'work-based pension schemes' include Defined Benefit and Defined Contribution occupational pension schemes, Group Personal Pensions (GPPs) and the new system of Personal Accounts. GPPs are a type of personal pension that are set up by employers for their employees.

[4] If they are eligible for the compulsory employer contribution i.e. if they earn more than £5,000 and remain in the scheme

[5] PPI calculation using DWP estimates; 12.4m – 3.5m = 8.9m (see Figure 1). This is an underestimate since it assumes that all of the 3.5 million people shown as 'Earning under £5,000 or aged under 22' were not in a work-based pension scheme.

enrolment or an employer contribution. These people could choose to opt in to Personal Accounts as an alternative to existing forms of saving.

Figure 1:[6] **Government estimates of eligibility for auto enrolment (millions)**



Source: DWP modelling based on Family Resources Survey 2004/05, Employers' Pension Provision Survey 2005, and Annual Survey of Hours and Earnings 2004 and Small and Medium-sized Enterprise Statistics 2004

Note: Figures may not sum due to rounding.

Around 7 million people received a contribution into a personal pension in 2004/5.[7] This includes people in Group Personal Pensions (GPP), which are a type of personal pension that are set up by employers for their employees, as well as people saving in other, individual personal pensions. The Government analysis in Figure 1 includes Group Personal Pensions in the definition of a 'scheme'. The Government is considering whether employers should be able to offer their employees a GPP instead of an occupational pension scheme or Personal Accounts.[8]

However, it is important to note that Figure 1 does not include other personal pensions that are set up as individual arrangements, rather than

[6] DWP figure taken from Department for Work and Pensions (DWP) 2006d p 65
[7] HMRC Table 7.11; National Statistics from HMRC website
[8] See Department for Work and Pensions (DWP) 2007 chapter 5 for the Government's response to stakeholders on GPPs and the European Distance Marketing Directive

being 'work-based'. Some of the people who are shown as being auto enrolled in Figure 1 may already be saving in an individual personal pension. This means that they may not be 'new pension savers', although they will be 'new work-based pension savers'.

Participation rates are uncertain

It is difficult to predict how many people will decide to opt out of pension saving, since the UK would be only the second country to introduce a national system of auto enrolment with the option to opt out. The other example, New Zealand's KiwiSaver, went live on 1 July 2007. While the New Zealand Government estimates for participation and early monitoring data may provide some insight into potential participation rates for Personal Accounts, there are significant design differences between the two schemes that may make meaningful comparisons difficult.[9]

Studies in the US and the UK have found that auto enrolment increases participation in occupational pension schemes:

- A study conducted in the US found that, after four years of service, the proportion of employees in a 401k scheme was nearly 100% among employees who were auto enrolled compared to 70% when employees are required to actively opt in.[10]
- In the UK in 2004 Defined Contribution schemes that used auto enrolment of eligible employees had 85% participation, compared to 57% in schemes where employees were required to actively opt in.[11]
- Other UK research found 90% participation where auto enrolment exists.[12]

The higher participation rates in auto-enrolment schemes may reflect the fact that it overcomes people's inertia; but they could also reflect the effects of other factors, such as more proactive employer involvement or more generous employer contribution rates in schemes which already use auto enrolment. The studies can therefore only be taken as one indication of the possible effects of auto enrolment on participation.

[9] See Appendix 1 for more details of KiwiSaver
[10] Madrian 2001 cited by The Pensions Commission 2004 p 208
[11] Note: Based on employers with 12 employees and over only. Participation rates were even higher in Defined Benefit schemes. Source: GAD 2005 cited by The Pensions Commission 2005 p 69
[12] Note: Based on a survey of private companies with at least five employees. Source: Deloitte 2006a p 17

Participation scenarios

Given the uncertainty about how individuals will respond to the reforms, the PPI has modelled the potential impact of three different participation scenarios on the number of additional savers. The scenarios are intended to illustrate some possible outcomes, rather than to be forecasts, and the analysis does not include employees and employers in the public sector.

- Optimistic scenario: 20% of eligible employees opt out of work-based saving, in line with the top range estimate made by the Government, and 0.9m self-employed and 0.9m other individuals opt in.
- Central scenario: 33% of eligible employees opt out of work-based saving, in line with the central case estimate made by the Government, and 0.75m self-employed and 0.6m other individuals opt in.[13]
- Pessimistic scenario: 50-60% of eligible employees opt out of work-based saving, in line with the lower estimate made by the UK Government and the lower participation estimate made by the New Zealand Government for KiwiSaver, and 0.5m self-employed and 0.3m other individuals opt in.

As well as replicating the Government's optimistic and central scenarios, which are supported by research evidence, we include a pessimistic scenario to illustrate the potential impact of low participation. The pessimistic scenario shows a range, from the UK Government's lower estimate (50% opt out) to the New Zealand Government's lower participation estimate projected for KiwiSaver (60% opt out), which is the only other national auto-enrolment pension saving scheme with an option to opt out.[14]

Effect of the reforms

There would be a substantial increase in the number of people saving in a work-based pension with an employer contribution in all of the participation scenarios in 2012/13, compared to without reform. This includes people in Personal Accounts and existing forms of work-based pension provision.

There are large differences between the different scenarios (Table 1):

- An optimistic scenario could potentially result in around 9 million new savers in work-based pension schemes.
- The central scenario could potentially result in around 7 million new savers in work-based pension schemes.
- The pessimistic scenario could potentially result in around 4 to 5 million new savers in work-based pension schemes.

[13] Department for Work and Pensions (DWP) 2006e paragraphs 2.50, 2.56, 2.58

[14] See Appendix 1 for more on the KiwiSaver assumptions. Note that there are significant design differences between Personal Accounts and KiwiSaver. These differences could reduce the relevance of participation estimates and early monitoring data.

Table 1:[15] New savers in work-based pension schemes under the reforms, in different participation scenarios

	Number in group (DWP estimate)	Optimistic scenario (20% opt out)	Central scenario (33% opt out)	Pessimistic scenario (50%-60% opt out)
Private sector employees who are not in a work-based pension scheme and who will be eligible for auto enrolment	8.9m[16]	7.1m	5.9m	3.6m to 4.5m
Private sector employees who are not in a work-based pension scheme and who will not be eligible for auto enrolment, plus people who are economically inactive or unemployed. These people could voluntarily opt in to Personal Accounts	12.3m	0.9m	0.6m	0.3m
The self-employed, who could voluntarily opt in to Personal Accounts	2.8m	0.9m	0.75m	0.5m
Total new savers in work-based pension schemes under the reforms		8.9m	7.3m	4.4m to 5.3m

It is important to note that Table 1 shows the number of new savers in work-based pension schemes. Not all of these are new savers, since:

- Some of the individuals may have been previously saving in a non-work based pension, such as an individual personal pension. Data on personal pensions is extremely limited. On one estimate, around 2 million employees are saving in an individual personal pension but not also in a work-based pension scheme.[17] In the extreme scenario that all of these 2 million people are auto enrolled into a work-based pension scheme and remain opted in, the number of new pension savers could be 2 million people lower than the number of new work-based pension savers shown in Table 1. However, it is not known how many of the 2 million would be auto enrolled, so levels of

[15] Figures for the number of people in the different groups are Government analysis from Figure 1, figures for assumed levels of opt in are Government analysis from Department for Work and Pensions (DWP) 2006e, figures for the number of people remaining opted in are PPI analysis based on Figure 1. Data relates to 2004/5.
[16] This is an underestimate since it assumes that all of the 3.5 million people shown as 'Earning under £5,000 or aged under 22' in Figure 1 were not in a work-based pension scheme.
[17] PPI analysis based on The Employers' Pension Provision Survey 2005 (Department for Work and Pensions (DWP), 2005), Family Resources Survey 2005/6 and HMRC tables. There are approximately 2 million employees with an individual personal pension whose pension receives a contribution (on top of the contracted-out rebate) but who are not also saving in a work-based pension scheme. Data on personal pension membership is extremely limited and should be treated with caution.

displacement from non-work based pensions to work-based pension schemes are very uncertain.
- Some of the individuals in Table 1 may have been previously making non-pension saving (such as saving in bank accounts or Individual Savings Accounts) to pension saving. The reforms may lead to a reduction in non-pension saving as a result of people saving more in pensions.

The reforms may also benefit some people who were already saving in work-based pension schemes. The Government estimates that around 2 million private sector employees are currently saving in a work-based pension scheme with less than a 3% employer contribution.[18] These people could potentially have their employer contribution increased to 3% of band earnings as a result of the reforms.[19]

Would saving be suitable for all?

The Government has said that the proposals ***are designed to increase the number of people saving for a pension.***[20] This chapter shows that the reforms could result in at least 4-5 million new savers in work-based pension schemes and possibly up to 9 million. This could mean that more people have an adequate income in retirement.

However, higher participation may not be a successful outcome if it means that more people are saving, but saving is not suitable for them.[21] Pension saving may not be suitable for an individual because they are likely to get a low return on their saving (because of the interaction of their saving with means-tested benefits in retirement) or because the pension contributions may be unaffordable or because of significant amounts of personal debt. Some stakeholders have expressed concern that saving may not be suitable for all people who are auto enrolled. Previous PPI research has shown that some groups of people may receive lower returns from saving in a Personal Account than others.[22]

This chapter has explored the potential impact of individuals' behaviour on the additional number of people saving for a pension as a result of the reforms. However, employers will have decisions on how to respond to the reforms, as well as individuals. The next chapter will explore the potential impact of employers' behaviour on annual total pension contributions.

[18] DWP estimate from Figure 1
[19] If they earn more than £5,000 (so they are eligible for the employer contribution)
[20] Department for Work and Pensions (DWP) 2006c p 3
[21] Elsewhere, the PPI has defined saving as being 'suitable' if individuals do not lose out as a result of their saving. This is a less stringent definition than ensuring that saving is the right thing for all consumers, which would be more consistent with the FSA's definition of 'suitability'. See Pensions Policy Institute (PPI) 2006 for analysis on the suitability of Personal Accounts.
[22] Pensions Policy Institute (PPI) 2006

Chapter 2: Employer behaviour and the value of annual contributions

The reforms will have cost implications for most employers. This is because of the higher levels of participation in schemes that is likely to result from the requirement on employers to automatically enrol their employees into pension saving and to contribute at least 3% for employees who remain opted in.

Employers may be able to pass these costs on in a variety of ways, for example, to consumers through higher prices, to workers through lower wage increases, or to shareholders or owners through lower profits. However, employers who already contribute more than 3% of band earnings could decide to reduce their contributions as a way of meeting the cost of the reforms.

This chapter uses four stylised scenarios to explore the possible implications of employers responding in different ways. Evidence on likely employer responses is limited, so the scenarios seek to illustrate the potential impact of a range of scenarios, rather than imply that any of the scenarios is more likely to occur. The analysis shows that the reforms could increase annual total pension contributions, although employer responses will be very important in determining the total impact of the reforms on pension saving:

- If no employer decides to pass on the costs of the reforms by reducing their pension contributions, the reforms could increase annual total pension contributions (made by individuals, employers and the state combined) by around £10 billion in 2012 compared to without reform.
- Even if all of the employers who can reduce their pension contributions to hold their pension costs constant do so, the reforms could still increase annual total pension contributions by around £5 billion in 2012 compared to without reform. This is because employers who do not already offer the minimum 3% contribution to employees in work-based schemes will be compelled to do so under the reforms.
- If employers act in line with a survey of their likely responses, the reforms could increase annual total pension contributions by around £10 billion in 2012 compared to without reform. However, some employers have said they will close their existing schemes or reduce their pension contributions as a result of the reforms. The reforms could still increase annual total pension contributions in 2050 but by less than £2.5 billion compared to without reform.
- It is important that employers continue to offer more than the 3% minimum contribution. In the extreme situation where no employer offers more than the minimum, annual total pension contributions could be £10 billion lower in 2050 than without reform.

How could pension provision evolve without reform?
Although Defined Benefit (DB) pension provision has been declining in the private sector in recent years, there is not a consensus view among pension experts on the future of DB schemes.[23] How the sector evolves will largely depend on how employers and Government respond to underlying cost pressures. As DB schemes close, Defined Contribution (DC) schemes could be an increasingly important part of work-based pension provision.

This paper will compare possible outcomes from the reforms against a baseline that assumes the reforms are not introduced. The key assumptions in the no-reform scenario are (see Appendix 2 for more details of the no-reform scenario):

- The number of active members in private sector Defined Benefit schemes would reduce by two-thirds by 2035.
- The employers who close a DB scheme all open a Defined Contribution (DC) scheme in its place.
- The number of people saving in a pension increases gradually over time as a result of population growth.
- Average contribution rates in Defined Contribution rates are assumed to increase over time, from around 9% of all earnings to around 11% of all earnings.[24] This is a consequence of the employers who switch from DB to DC provision being assumed to offer a higher contribution rate on average than current employers who already offer DC schemes.

Annual total pension contributions to private sector pension schemes are projected to fall in the no-reform scenario from around £40 billion in 2006 to around £30 billion by 2050 (in 2006/7 earnings terms). These and other contribution projections in this report include employer contributions, employee contributions and tax relief. The decline is largely a result of the assumptions made about closure of DB schemes.

It is uncertain how pension provision will evolve in the absence of reform. The no-reform scenario is not a forecast but provides a baseline for illustrating the effect of the reforms.

Employer behaviour
The reforms will compel employers to contribute at least 3% of band earnings for employees who are eligible for automatic enrolment and remain opted in to pension saving.

Currently, around 15% of private sector employers offer schemes that are more generous than the 3% minimum contribution and these schemes

[23] Pensions Policy Institute (PPI) 2007d p 4
[24] Government Actuary Department (GAD) 2006 para 8.. This figure includes contracted-out rebates, although an allowance is made in the modelling for the abolition of contracting-out for Defined Contribution pension schemes that has been legislated for in Pension Act 2007.

provide pensions for 23% of all employees.[25] If these employers already have high participation rates, then they may not see significant cost increases as a result of the reforms. If, however, these employers have low participation rates, their costs could increase substantially as a result of auto enrolment.

The remaining 85% of private sector employers do not currently contribute at least 3% into a pension scheme. These employers could see significant cost increases as a result of the reforms if they have employees who are eligible for auto enrolment.

Employers who face an additional cost as a result of the reforms could choose to pass on some or all of it to:
1. Consumers, through higher prices.
2. Shareholders or owners, through lower profits.
3. Employees, for example, through lower wages.
4. Pension scheme members, through lower contributions, if they already contribute more than the 3% minimum. This could be for existing members of the scheme or for new enrolments.

The possibility that some employers might reduce their pension contributions in order to meet the cost of the reforms has been referred to as 'levelling down'.

Employers are not a homogeneous group and, in practice, they will pass on the cost in a mixture of the four possible ways. Surveys of likely employer responses have been conducted but have produced mixed evidence for how employers might respond. What the surveys have in common is that a significant proportion of employers are not yet sure how they will react to the reforms.[26] Available research offers some indication of employers' intended behaviour but it is not possible to predict with certainty how employers will react five years in advance of the introduction of the reforms.

The remainder of this chapter uses four scenarios to explore the possible outcomes of the reforms. The analysis only includes private sector employers. The scenarios assume that these employers react in certain ways. They are stylised because they tend to assume that all private sector employers act in the same way, whereas in reality employers will react in different ways depending on their own circumstances and

[25] Department for Work and Pensions (DWP) 2006b p 116 para 6.7. Note that the majority of employers are small employers who are less likely to offer a pension contribution.
[26] For example, a survey by the DWP found that a third of employers were unaware of the reforms proposed by the Pensions Commission. A smaller survey by Deloitte found that 30% of employers were still unsure about how they would react to the proposals. Note that the DWP survey was conducted before the reforms were announced in the May 2006 White Paper. It therefore referred to the Pensions Commission's proposals for a National Pension Savings Scheme (NPSS), rather than Personal Accounts. For the DWP survey, see Department for Work and Pensions (DWP) 2006a cited in Department for Work and Pensions (DWP) 2006c p 119 para 5.33. See Deloitte 2006a and Deloitte 2006b for more details of the Deloitte survey.

preferences. All of the scenarios are based on an overnight introduction of the reforms in 2012. In reality the Government intends to phase in the compulsory employer contribution over a three-year period at the rate of 1% each year.

Scenarios are useful to explore outcomes on the basis of certain assumptions (i.e. to answer questions like: *What will happen if employers behave in this way?*). The scenarios are intended as illustrative rather than as forecasts. We do not estimate the likelihood of each scenario occurring.

If a forecast of annual total pension contributions were to be produced, it would need to allow for factors that are not allowed for in this paper. For example, it would need to allow for the possibility that individuals in Personal Accounts contribute more than the minimum 4%, or that some employers who use a pension scheme to attract and retain employees increase their contributions under the reforms in order to maintain the differential they currently have over their competitors. It would also be necessary to allow for the proposed phased introduction of the reforms, rather than assuming immediate introduction of the reforms from 2012.

There is a lot of uncertainty about how employers will respond to the reforms, and the projections illustrated in this paper should not be taken as forecasts. The analysis seeks to illustrate the potential impact of a *range* of possible scenarios and is not intended to imply that any of the scenarios is more likely to occur than the others.

The scenarios in this chapter use the central participation assumptions from Chapter 1. Unlike Chapter 1, they make an allowance for the possible displacement from non work-based pensions to work-based pension schemes. This is based on the estimate that there are around 2 million employees saving in an individual personal pension but not also in a work-based pension.[27] As Chapter 1 noted, it is not known how many of these would be auto enrolled into work-based pension schemes. A heavily stylised assumption has therefore been made that half of these people (i.e. a total of 1 million people) stop contributing to non work-based pensions as a result of joining a work-based pension scheme. Further, half of the 0.75 million self-employed who are assumed to voluntarily opt in to Personal Accounts are assumed to stop contributing to a personal pension as a result of the reforms.

What if employers auto enrol on existing terms?

This 'employers enrol on existing terms' scenario explores what could happen if employers that already offer a pension scheme with at least a

[27] PPI analysis based on The Employers' Pension Provision Survey 2005 (Department for Work and Pensions (DWP), 2005), Family Resources Survey 2005/6 and HMRC tables. There are approximately 2 million employees with an individual personal pension whose pension receives a contribution (on top of the contracted-out rebate) but who are not also saving in a work-based pension scheme. Data on personal pension membership is extremely limited and should be treated with caution.

3% employer contribution decide to keep the scheme open on the same terms as would be the case without reform. They therefore pass on the cost of the increased participation resulting from auto enrolment to consumers, shareholders or to employees in lower wages, but not by reducing pension contributions.

Employers who do not already offer a pension scheme (or who offer less than a 3% employer contribution) are assumed to offer the minimum 3% employer contribution, either within an existing type of pension provision or in a Personal Account. The assumed position of employees in the existing terms scenario is described in Table 2. The scenario is stylised, since it assumes that no employer passes on the cost of the reforms by reducing pension contributions.

Table 2:[28] Assumptions in the 'employers enrol on existing terms' scenario

		Number in 2012	Assumption made
People who are already saving in work-based pension schemes or who will be auto enrolled	Public sector employees	6.4m	Not included in the analysis
	Private sector employees who are already in work-based pension schemes with an employer contribution of at least 3%	4.3m	Employee and employer make the same contribution as they would without reform
	Private sector employees who are auto enrolled into existing types of pension provision	2.5m[29]	Employee and employer make average contribution rate in existing types of provision
	Private sector employees who are auto enrolled into Personal Accounts	8.3m	Employee and employer make minimum contribution rates
	Total	21.5m	
People who voluntarily opt in	Self-employed people who voluntarily opt in to Personal Accounts	0.75m[30]	Individual makes minimum contribution. No employer contribution.
	Other people who voluntarily opt in to Personal Accounts[31]	0.6m[32]	Individual makes minimum contribution. No employer contribution.
	Total	1.35m	

[28] PPI assumptions based on the Government estimates in Figure 1 in Chapter 1
[29] PPI assumption. The number of people who will be auto enrolled into existing types of provision is very uncertain, so the 2.5m is a stylised assumption for modelling purposes.
[30] DWP central estimate, Department for Work and Pensions (DWP) 2006e para 2.56
[31] These could be employees who are not auto enrolled, people who are economically inactive or people who are unemployed
[32] DWP central estimate, Department for Work and Pensions (DWP) 2006e para 2.58

In this scenario, the reforms would increase annual total pension contributions. This is because the reforms are assumed to increase participation in pension saving without decreasing contributions for anybody.

In 2012, annual total pension contributions would be £45 billion in this scenario, compared to £35 billion without reform (Table 3), an increase of around £10 billion. This level of increase would be maintained over time. For example, annual total pension contributions in 2050 would be around £10 billion higher than without reform, at £40 billion rather than £30 billion without reform.

Table 3:[33] Annual total pension contributions (from employers, individuals and the state combined) to private sector pension schemes in the 'employers enrol on existing terms' scenario, in £ bn, in 2006/7 earnings terms

	No reform scenario	Employers enrol on existing terms	Increase due to reform
2012[34]	35	45	+10
2020	35	45	+10
2030	30	40	+10
2040	30	40	+10
2050	30	40	+10

The totals and the differences shown have been rounded independently to the nearest £5 billion, so the differences may not correspond to the totals shown due to rounding

What if employers reduce contribution rates?

This 'cost control' scenario explores what could happen if the employers that could pass on the costs of the reforms through lower pension contributions decide to use this approach:

- Employers who contribute more than the 3% minimum into a pension scheme reduce their contributions to pass on the costs of increased auto enrolment.
- Employers who do not already offer a pension scheme (or who offer less than a 3% employer contribution) cannot reduce their contributions. They are assumed to pass on the cost in one of the other three ways: to shareholders, consumers, or to employees in lower wages.

Again, this is a stylised scenario, because it assumes that all employers who can lower their pension contributions do so. However, even in this

[33] PPI analysis using the Aggregate Model. Includes all funded occupational pension schemes in the private sector and all group personal pensions, personal pensions and stakeholder pensions. Excludes the Local Government pension schemes. Contributions include individual and employer contributions, the Government contribution through tax relief and contracted-out rebates for Defined Benefit schemes. See Appendix 3 for details of the modelling assumptions and methodology.

[34] The analysis throughout this report assumes immediate introduction of auto enrolment and compulsory employer contributions from 2012; in fact, the Government has proposed phased introduction of these reforms.

scenario, the reforms would still increase annual total pension contributions by around £5 billion in 2012 compared to without reform (Table 4). This is because employers who do not already offer the minimum 3% contribution to employees in work-based schemes will be compelled to do so under the reforms.

Table 4:[35] Annual total pension contributions (from employers, individuals and the state combined) to private sector pension schemes in the 'cost control' scenario, in £ bn, in 2006/7 earnings terms

	No reform scenario	Cost control scenario	Increase due to reform
2012[36]	35	45	+5
2020	35	40	+5
2030	30	40	+5
2040	30	40	+5
2050	30	40	+5

The totals and the differences shown have been rounded independently to the nearest £5 billion, so the differences may not correspond to the totals shown due to rounding

What if the employers act in line with a survey?

This 'modelled employer response' scenario explores what will happen if employers act in the way suggested by the survey conducted by Deloitte of their likely responses to the reforms.[37] The Deloitte survey has been chosen because it is the most recent survey of likely employer responses.

The scenario should be taken as illustrative, since there is limited evidence for how employers will react to the reforms and a significant minority are still not yet aware of the reforms. In this scenario, employers are assumed to act in different ways, with some keeping their scheme open on current terms and others closing their scheme or reducing their contribution levels (Box 2).

[35] PPI analysis using the Aggregate Model. Includes all funded occupational pension schemes in the private sector and all group personal pensions, personal pensions and stakeholder pensions. Excludes the Local Government pension schemes. Contributions include individual and employer contributions, the Government contribution through tax relief and contracted-out rebates for Defined Benefit schemes. See Appendix 3 for details of the modelling assumptions and methodology.

[36] The analysis throughout this report assumes immediate introduction of auto enrolment and compulsory employer contributions from 2012; in fact, the Government has proposed phased introduction of these reforms.

[37] See Deloitte 2006a and Deloitte 2006b for more details of the Deloitte survey

Box 2: The modelled employer response scenario

Employers are assumed to act in line with a survey conducted by Deloitte of their reported likely responses to the reforms.[38] The PPI's modelling in this paper is informed by modelling conducted by other organisations using this survey (Table 5).[39]

Table 5:[40] Assumptions made in the modelled employer response scenario for employers running existing exempt pension schemes

	DB schemes: % of members	DC schemes: % of members
Open and grow Keep scheme open for all new recruits, applying auto enrolment to the existing scheme on existing terms.	12%	31%
Open and reduce Keep scheme open for all new recruits but reduce contribution rates for new and existing members.	8%	11%
Limit and maintain Restrict eligibility so that only senior managers are able to join the existing scheme on existing terms in future. Individuals who already belong to existing schemes can continue accruing new pension rights on existing terms until they leave the company.	19%	37%
Shrink and maintain[41] Close schemes altogether for new members but retain contribution rates for existing members. Individuals who already belong to existing schemes can continue accruing new pension rights on existing terms until they leave the company.	61%	13%
Shrink and reduce Close schemes to new members and future accruals.	0%	8%

There is limited information from the survey about whether employers would auto enrol their employees into an existing type of pension scheme or into a Personal Account. Nor is there much evidence on whether they would close their existing scheme and how much their contribution would be. Some stylised assumptions have therefore been made. Half of employees who are not eligible to join existing schemes on existing terms from 2012 are assumed to instead receive combined contributions of 9% of all earnings into an existing type of pension provision.[42] The other half receive a combined contribution of 8% of band earnings into a Personal Account.

[38] Deloitte 2006a
[39] NAPF 2006
[40] Based on NAPF 2006 Table 4
[41] Defined Benefit schemes that have already closed to new members, or that are assumed to do so before 2012, are included in this row
[42] This is the current average contribution rate into Defined Contribution schemes (including employee contributions, employer contributions and tax relief). Source: Government Actuary Department (GAD) 2006 para 8.8

In this scenario, the reforms could increase annual total pension contributions in 2012 from £35 billion without reform to £45 billion with reform, an increase of around £10 billion (Table 6). This is the same as the employers enrol on existing terms scenario. However, annual total pension contributions would decrease over time in the modelled employer response scenario, as gradually more and more employers either close their scheme or reduce their contribution levels. The reforms would still increase annual total pension contributions in 2050 but by less than £2.5 billion compared to without reform.

Table 6:[43] Annual total pension contributions (from employers, individuals and the state combined) to private sector pension schemes in the 'modelled employer response scenario', in £ bn, in 2006/7 earnings terms

	No reform scenario	Modelled employer response scenario	Increase due to reform
2012[44]	35	45	+10
2020	35	40	+5
2030	30	35	+5
2040	30	35	+*
2050	30	35	+*

The totals and the differences shown have been rounded independently to the nearest £5 billion, so the differences may not correspond to the totals shown due to rounding. '' denotes a figure of less than £2.5 billion.*

What if the minimum contribution levels become the norm?

This 'employers enrol on minimum terms' scenario explores what would happen if the minimum 8% combined contribution level becomes the norm in work-based pension saving. Again, this is a stylised scenario. Some employers may do this if they see the minimum as an 'acceptable amount' to save in a pension, for example. However, this scenario is very extreme because it assumes that all employers behave in this way. Also, some individuals may increase their own contributions to compensate for any reductions made by their employers.

[43] PPI analysis using the Aggregate Model. Includes all funded occupational pension schemes in the private sector and all group personal pensions, personal pensions and stakeholder pensions. Excludes the Local Government pension schemes. Contributions include individual and employer contributions, the Government contribution through tax relief and contracted-out rebates for Defined Benefit schemes. See Appendix 3 for details of the modelling assumptions and methodology.

[44] The analysis throughout this report assumes immediate introduction of auto enrolment and compulsory employer contributions from 2012; in fact, the Government has proposed phased introduction of these reforms.

Employers who contribute more than 3% into a work-based pension scheme in 2012 are assumed to maintain their current contribution rates for existing members. They offer new enrolments the 3% minimum contribution level. Employers who operate DC schemes are assumed to retain their existing scheme but reduce the contribution rate to 3% for new enrolments. Employers who operate DB schemes are assumed to close the scheme altogether; half are assumed to set up a DC scheme while the other half use Personal Accounts.

Employees who are already receiving more than 3% in 2012 continue to do so until they change job but, in the long term, all work-based pension saving is at the minimum possible level. Non work-based pension provision is assumed to continue at the same level as in the other reform scenarios, so not all existing pension provision is assumed to reduce to the 8% level in this scenario.

In the employers enrol on minimum terms scenario, the reforms could increase annual total pension contributions in 2012 from £35 billion without reform to £45 billion with reform, an increase of around £10 billion (Table 7). This is the same as the employers enrol on existing terms scenario. However, annual total pension contributions would reduce rapidly over time as employees change jobs. By 2050, annual total pension contributions could be £10 billion lower than without reform.

Table 7:[45] Annual total pension contributions (from employers, individuals and the state combined) to private sector pension schemes in the 'employers enrol on minimum terms' scenario, in £ bn, in 2006/7 earnings terms

	No reform scenario	Employers enrol on minimum terms scenario	Increase due to reform
2012[46]	35	45	+10
2020	35	30	-5
2030	30	25	-5
2040	30	25	-10
2050	30	25	-10

The totals and the differences shown have been rounded independently to the nearest £5 billion, so the differences may not correspond to the totals shown due to rounding

[45] PPI analysis using the Aggregate Model. Includes all funded occupational pension schemes in the private sector and all group personal pensions, personal pensions and stakeholder pensions. Excludes the Local Government pension schemes. Contributions include individual and employer contributions, the Government contribution through tax relief and contracted-out rebates for Defined Benefit schemes. See Appendix 3 for details of the modelling assumptions and methodology.

[46] The analysis throughout this report assumes immediate introduction of auto enrolment and compulsory employer contributions from 2012; in fact, the Government has proposed phased introduction of these reforms.

Summary

The reforms would lead to a significant increase in annual total pension contributions in most of the scenarios (Table 8). The extreme 'employers enrol on minimum terms' scenario is the exception.

Although annual total pension contributions would be higher than without reform under most of the scenarios, there would also be around 7 million more savers in work-based pension schemes.[47] This means that the distribution of saving could be different from what it would have been without reform and the average contribution made for an individual could be lower. This poses the question of whether the reforms would be considered successful if they did not increase annual total pension contributions but did increase the number of people saving and made the distribution of saving more equal.

Table 8:[48] Annual total pension contributions (from employers, individuals and the state combined) to private sector pension schemes, and increase due to reform, in £bn, in 2006/7 earnings terms

	No reform scenario	Employers enrol on existing terms	Cost control	Modelled employer response	Employers enrol on minimum terms
Annual total pension contributions					
2012[49]	35	45	45	45	45
2020	35	45	40	40	30
2030	30	40	40	35	25
2040	30	40	40	35	25
2050	30	40	40	35	25
Increase due to reform					
2012	-	+10	+5	+10	+10
2020	-	+10	+5	+5	-5
2030	-	+10	+5	+5	-5
2040	-	+10	+5	+*	-10
2050	-	+10	+5	+*	-10

The totals and the differences shown have been rounded independently to the nearest £5 billion, so the differences may not correspond to the totals shown due to rounding. '*' denotes a figure of less than £2.5 billion.

[47] In the central participation scenario from Chapter 1, which is used for this chapter

[48] PPI analysis using the Aggregate Model. Includes all funded occupational pension schemes in the private sector and all group personal pensions, personal pensions and stakeholder pensions. Excludes the Local Government pension schemes. Contributions include individual and employer contributions, the Government contribution through tax relief and contracted-out rebates for Defined Benefit schemes. See Appendix 3 for details of the modelling assumptions and methodology.

[49] The analysis throughout this report assumes immediate introduction of auto enrolment and compulsory employer contributions from 2012; in fact, the Government has proposed phased introduction of these reforms.

The scenarios are stylised and a range of outcomes is possible. Annual total pension contributions could potentially be higher than the employers enrol on existing terms scenario or lower than the employers enrol on minimum terms scenario, because:

- None of the scenarios assume that employers increase their pension contributions as a result of the reforms. Some employers who use their pension scheme to attract and retain employees might increase their contributions in order to maintain the differential they currently have over their competitors (who would offer at least the 3% minimum under the reforms).
- All of the scenarios assume that individuals contribute the minimum 4% of band earnings to work-based pension saving, unless they are already saving more than this amount. Higher individual contributions are possible and could be influenced by employer contribution levels.
- All of the scenarios assume that 1 million employees stop saving in a non-work based personal pension as a result of the reforms. This number could be higher or lower.
- All of the scenarios assume the central participation rates from Chapter 1. Participation could be higher or lower than assumed and could be influenced by employer contribution levels. The relationship between opt out rates and employer contribution levels is complex. For example, if employer contributions are more generous, employees may be less inclined to opt out. However, higher participation could in turn increase the costs that employers face and lead to lower levels of employer contributions.

Although surveys of likely employer responses have been conducted, they cannot predict with certainty how employers will act five years in advance of the reforms being introduced. Given the significant impact that employer behaviour will have on the outcome of the reforms, it will be important to continue to build the evidence base on employer responses in the period leading up to the introduction of the reforms.

Employers will have a choice about whether to auto enrol their employees into existing types of pension provision or into Personal Accounts. Employers' decisions will have implications for the shape of the pensions market. The following chapter explores the split of annual contributions and the size of pension funds between existing types of pension provision and Personal Accounts for each of the reform scenarios.

Chapter 3: Demand for Personal Accounts and the impact on the wider market

Employers will have a choice about whether to auto enrol their employees into an existing pension scheme or into Personal Accounts. This chapter uses the stylised scenarios from Chapter 2 to illustrate the potential shape of the pensions market post reform if employers act in certain ways. Employers will have the choice of auto enrolling their employees into an existing pension scheme or into a new national system of Personal Accounts. Their decisions will affect the shape of the pensions market and the split of the market between existing types of work-based pension provision and the new Personal Accounts.

In all of the scenarios, the bulk of the growth in the aggregate size of pension funds will be in Personal Accounts.
- **If employers do not reduce their individual contributions, or if they hold their total contributions constant, then annual pension contributions to existing types of provision could be slightly higher than without reform.**
- **If employers do reduce their contributions for some or all future employees, then annual pension contributions to existing types of provision could be significantly lower than without reform by 2050.**

The aggregate size of pension funds in Personal Accounts will take some time to build up and may remain a small part of the total.
- **If employers do not reduce their individual contributions, or if they hold their total contributions constant, then only a fifth of the total value of pensions funds could be in Personal Accounts by 2050.**
- **If employers do reduce their contributions for some or all employees, between a third and a half of the total value of pensions funds could be in Personal Accounts by 2050.**

Private sector fund managers and administrators will be used for Personal Accounts. This means that even if Personal Accounts makes up a significant proportion of funds by 2050, this could provide new opportunities for the private sector.

Employers' decisions

Employers will have a choice about whether to auto enrol employees into an existing type of pension scheme or into Personal Accounts. For employers who already offer a work-based scheme the decision on whether or not to switch to Personal Accounts is not straightforward and employers might reasonably be expected to act in different ways.

Remaining with existing provision could have many advantages:
- Allow employers to retain flexibility, for example in making contributions that go beyond the annual contribution limit of £3,600 for Personal Accounts.

- Prevent extra layers of complexity being added to an employer's pension arrangements. Since transfers into Personal Accounts will not be allowed, at least initially,[50] switching to Personal Accounts could only be for the build-up of new pension rights.
- Avoid the transitional risks and costs of changing arrangements, including communicating the change to employees.
- Be a way of allowing employers to draw on the expertise and products of the private sector more widely than pensions, for example, in the design of the overall remuneration package for employees.

There could also be some benefits to employers of switching to Personal Accounts which may:
- Reduce employer responsibilities, particularly for employers who currently administer a pension scheme themselves.
- Reduce the risks involved in running a pension scheme, for example the risk of a deficit emerging under a Defined Benefit pension scheme that then needs to be paid.
- Provide an opportunity to switch from a Defined Benefit to a Defined Contribution pension arrangement, or to reduce employer contributions closer to the 3% minimum level.

Potential division of contributions

This chapter uses the stylised scenarios from Chapter 2 to illustrate the potential shape of the pensions market post reform if employers act in certain ways. Chapter 2 showed projections of annual total pension contributions. For this chapter, the projections have been split into the amount of pension contributions going into existing forms of pension provision[51] and the amount going into Personal Accounts.

In the 'employers enrol on existing terms' scenario, the reforms could lead to a small increase in annual pension contributions to existing provision each year, compared to no reform. In addition there could be contributions of around £5 billion per annum into Personal Accounts (Table 9).

In the 'cost control' scenario, the reforms could lead to a small increase in annual pension contributions to existing provision each year, compared to no reform. This is because the employers who currently run a scheme but contribute less than 3% would be compelled to increase their contributions as a result of the reforms. In this scenario contributions into Personal Accounts could be around £5 billion per annum.

[50] The Government originally suggested that the ban on transfers into Personal Accounts might be reviewed in 2020; this has now been brought forward to 2017. See Department for Work and Pensions (DWP) 2007 p 96
[51] Existing provision includes existing occupational Defined Benefit and Defined Contribution schemes, group and individual personal pensions and stakeholder pensions.

If employers act in line with a survey of their reported likely responses, then annual pension contributions to existing provision could be £10 billion lower than without reform by 2050. This is because some employers are assumed to switch from existing provision to Personal Accounts, which could see contributions of around £10 billion per annum by 2020.

If employers enrol on minimum terms and this becomes the norm in work-based pensions, then annual pension contributions to existing provision could be £20 billion lower than without reform by 2030. In this scenario contributions into Personal Accounts could be around £10 billion per annum.

There is a lot of uncertainty about how employers will respond to the reforms, and the projections illustrated in this paper should not be taken as forecasts. The analysis seeks to illustrate the potential impact of a *range* of possible scenarios and is not intended to imply that any of the scenarios is more likely to occur than the others.

Table 9:[52] Annual pension contributions (from employers, individuals and the state combined) to Existing Provision (EP) and Personal Accounts (PA), and increase due to reform, in £ bn, 2006/7 earnings terms

	No reform scenario		Employers enrol on existing terms		Cost control		Modelled employer response		Employers enrol on minimum terms	
	EP	PA	EP	PA	EP	PA	EP	PA	EP	PA
Annual pension contributions										
2012	35	-	40	5	35	5	40	5	35	10
2020	35	-	40	5	35	5	30	10	20	10
2030	30	-	35	5	30	5	25	10	15	10
2040	30	-	35	5	30	5	25	10	15	10
2050	30	-	35	5	30	5	25	10	15	10
Increase due to reform										
2012	-	-	+*	+5	+*	+5	+*	+5	+*	+10
2020	-	-	+*	+5	+*	+5	-5	+10	-15	+10
2030	-	-	+*	+5	+*	+5	-5	+10	-20	+10
2040	-	-	+*	+5	+*	+5	-5	+10	-20	+10
2050	-	-	+*	+5	+*	+5	-10	+10	-20	+10

The totals and the differences shown have been rounded independently to the nearest £5 billion, so the differences may not correspond to the totals shown due to rounding. '*' denotes a figure of less than £2.5 billion.

[52] PPI analysis using the Aggregate Model. Includes all funded occupational pension schemes in the private sector and all group personal pensions, personal pensions and stakeholder pensions. Excludes the Local Government pension schemes. Contributions include individual and employer contributions, the Government contribution through tax relief and contracted-out rebates for Defined Benefit schemes. See Appendix 3 for details of the modelling assumptions and methodology.

Aggregate size of pension funds

The aggregate size of pension funds under management is important for industry because many personal pension providers levy charges on individual members using an Annual Management Charge (AMC), which is expressed as a percentage of assets under management. For these providers, the total amount of revenue collected from charges will depend on the aggregate size of the pension fund.

In the absence of reform, the aggregate size of pension funds is projected to reduce over the long term, from around £1,100 billion in 2012 to around £800 billion by 2040 (Table 10). This is primarily the result of the assumed decline in private sector Defined Benefit schemes.[53] All of these funds would be held in existing provision, because without the reforms Personal Accounts would not exist.

Table 10:[54] The aggregate size of pension funds under management in the absence of reform, in £ bn, 2006/7 earnings terms

	Existing provision
2012	1,100
2020	1,000
2030	850
2040	800
2050	800

Potential division of pension funds

The aggregate size of pension funds in Personal Accounts will take some time to build up and may remain a small part of the total.

In the 'employers enrol on existing terms' scenario, the reforms would increase the aggregate size of pension funds (in existing provision and Personal Accounts combined) from around £800 billion in 2050 to around £1,000 billion, an increase of £200 billion (Table 11). Around £50 billion of this increase would be in existing provision, with the remainder in Personal Accounts. The aggregate size of pension funds in Personal Accounts would grow steadily to around £200 billion by 2050, around one-fifth of the total.

[53] The no reform scenario assumes that the proportion of employees who are active members of private sector Defined Benefit schemes will reduce to two-thirds of its current level by 2035

[54] PPI analysis using the Aggregate Model. Includes all funded occupational pension schemes in the private sector and all group personal pensions, personal pensions and stakeholder pensions. Excludes the Local Government pension schemes. Includes only assets held in respect of individuals who have not yet begun to use their pension saving to provide an income. Figures are rounded to the nearest £50 billion. See Appendix 2 for details of the pre-reform counterfactual.

Table 11:[55] The aggregate size of pension funds under management, split between Existing Provision (EP) and Personal Accounts (PA), and increase due to reform, in £ bn, 2006/7 earnings terms

	No reform scenario		Employers enrol on existing terms		Cost control		Modelled employer response		Employers enrol on minimum terms	
	EP	PA	EP	PA	EP	PA	EP	PA	EP	PA
Aggregate size of pension funds under management										
2012	1,100	-	1,100	+*	1,100	+*	1,100	+*	1,100	+*
2020	1,000	-	1,000	50	1,000	50	950	50	850	100
2030	850	-	900	100	850	100	750	150	600	200
2040	800	-	850	150	800	150	650	250	400	300
2050	800	-	800	200	800	200	600	300	350	350
Increase due to reform[56]										
2012	-	-	+*	+*	+*	+*	+*	+*	+*	+*
2020	-	-	+*	+50	+*	+50	-50	+50	-150	+100
2030	-	-	+*	+100	+*	+100	-100	+150	-300	+200
2040	-	-	+50	+150	+*	+150	-150	+250	-400	+300
2050	-	-	+50	+200	+*	+200	-150	+300	-450	+350

The totals and the differences shown have been rounded independently to the nearest £50 billion, so the differences may not correspond to the totals shown due to rounding. '*' denotes a figure of less than £25 billion.

The reforms would also increase the aggregate size of pension funds in the 'cost control' scenario. However, the growth would almost all be in Personal Accounts in this scenario. The aggregate size of pension funds in Personal Accounts could grow steadily to around £200 billion by 2050. The aggregate size of pension funds in existing provision in 2050 could be higher than without reform, but by less than £25 billion.

In the 'modelled employer response' scenario, the aggregate size of pension funds in Personal Accounts could reach £300 billion by 2050. There would be a fall in the aggregate size of pension funds in existing provision in 2050, by around £150 billion compared to without reform. In this scenario, roughly one-third of the aggregate size of pension funds would be in Personal Accounts by 2050.

The aggregate size of pension funds in Personal Accounts could reach £350 billion in the 'employers enrol on minimum terms' scenario, partly because of the assumption made that some Defined Benefit schemes switch to Personal Accounts. There could be a fall in the aggregate size of pension funds in existing provision in 2050, by around £450 billion

[55] PPI analysis using the Aggregate Model. Includes all funded occupational pension schemes in the private sector and all group personal pensions, personal pensions and stakeholder pensions. Excludes the Local Government pension schemes. Includes only assets held in respect of individuals who have not yet begun to use their pension saving to provide an income. See Appendix 3 for details of the modelling assumptions and methodology.
[56] The analysis throughout this report assumes immediate introduction of auto enrolment and compulsory employer contributions from 2012; in fact, the Government has proposed phased introduction of these reforms.

compared to without reform. In 2050, roughly one-half of the aggregate size of pension funds would be in Personal Accounts.

It is important to note that all of the figures are expressed relative to national average earnings in 2006/7. This means that, if Table 11 shows a fall in the aggregate size of pension funds, it only means that the size increases by less than average earnings growth, and not that the size reduces in nominal terms. For example, the aggregate size of pension funds in existing provision is projected to grow on average by 1.6% a year between 2012 and 2050 in the 'employers enrol on minimum terms' scenario.[57] Growth would be higher in the other scenarios (Table 12).

Table 12:[58] Average annual growth in the aggregate size of pension funds under management in existing provision between 2012 and 2050, in nominal terms

	No reform scenario	Employers enrol on existing terms	Cost control	Modelled employer response	Employers enrol on minimum terms
Average annual growth	3.7%	3.8%	3.7%	3.1%	1.6%

Private sector fund managers and administrators will be used for Personal Accounts. This means that even if Personal Accounts makes up a significant proportion of pensions funds by 2050, this could mean new opportunities for the private sector.

Chapters 1, 2 and 3 have analysed the possible effects of the Government's reforms on the number of people saving for a pension and the distribution of annual pension contributions and funds between existing provision and Personal Accounts. The next chapter draws out the policy implications and design choices that the Government may want to consider to increase the likelihood of a positive overall outcome from the reforms.

[57] This compares to assumed price inflation of 2.5% a year and assumed increases in national average earnings of 4.55% a year

[58] PPI analysis using the Aggregate Model. Includes all funded occupational pension schemes in the private sector and all group personal pensions, personal pensions and stakeholder pensions. Excludes the Local Government pension schemes. Includes only assets held in respect of individuals who have not yet begun to use their pension saving to provide an income. See Appendix 3 for details of the modelling assumptions and methodology.

Chapter 4: Policy implications and design choices

The reforms aim to enable individuals who are not already saving in a pension scheme to make their own provision for retirement. Specifically, the Government has said that its reforms aim:

- To increase the number of people saving for a pension.
- For Personal Accounts to complement, rather than compete with, existing good-quality pension provision.

There is the potential for the reforms to achieve both of these objectives. However, there can be tensions between the two objectives. Some policy options may contribute positively to both but most involve a trade-off between the two.

The analysis in Chapters 2 and 3 have shown that a range of outcomes is possible in relation to the number of savers and the balance of saving between Personal Accounts and existing provision. As such, employers' responses to the introduction of the reforms will be critical in determining the overall impact that the reforms have on the level of pension saving.

The reform objectives

The reforms ***aim to increase retirement income and promote personal responsibility by encouraging and enabling individuals not already saving in a pension scheme to make their own low cost retirement provision.***[59]

Specifically, the Government has identified two particular objectives that are necessary to achieve its overall aim:

1. ***Increase the number of people saving for a pension***
   The Government has estimated that around seven million people are currently under-saving for retirement.[60] It argues that there is generally low and ineffective demand from people on average and low incomes who do not have access to a company scheme, and that currently pension providers cannot profitably supply this group what is needed.[61] The Government has said that the proposals ***are designed to increase the number of people saving in a pension.***[62]

2. ***Complement existing good-quality pension provision***
   At the same time, the Government has recognised that ***where the problems of low demand and supply do not apply, the pensions market works very well.***[63] It has therefore said that ***Personal Accounts should complement, rather than compete with, existing good-quality pension***

[59] Department for Work and Pensions (DWP) 2006c p 3
[60] Department for Work and Pensions (DWP) 2006b p 9
[61] Department for Work and Pensions (DWP) 2006b p 10-12
[62] Department for Work and Pensions (DWP) 2006c p 3
[63] Department for Work and Pensions (DWP) 2006b p 13

provision.[64] This is consistent with the target group for Personal Accounts.[65]

Increase the number of people saving for a pension
Chapter 1 showed that, depending on the level of opt-out, the reforms could result in at least 4-5 million new savers in work-based pension schemes and possibly up to 9 million. However, the success of the reforms in this respect will depend on how individuals react to auto enrolment, or to being able to voluntarily join Personal Accounts.

Some parts of the reforms and some policy options specifically aim to increase the number of people saving for a pension. For example:

- ***Auto enrolment*** aims to tackle inertia and short-termism and is likely to increase the number of people saving in a pension.

- The ***employer contribution*** and ***government tax relief*** aim to increase the incentives to save and the value of saving for individuals.

- ***Low charges in Personal Accounts*** may make saving more attractive for some people.

- Some concerns have been expressed that pension saving may not be suitable for all of the employees that are auto enrolled. ***Increasing the suitability of saving*** might allow a clear message to be given about the value of saving in a pension, which could increase the number of savers. A variety of different policy options have been discussed as possible ways of reducing the risk that employees are auto enrolled into saving when it is not suitable for them.
    - Provide generic advice and information to help individuals make the right decision about whether to stay in or to opt out of Personal Accounts or an alternative scheme.
    - Not auto enrol some groups of people who are more likely to be at risk of low returns, such as low earners and today's older people.
    - Increasing the trivial commutation limit to allow more individuals to take their pension saving as a lump sum.[66]
    - Disregard a limited amount of pension income in the calculation of means-tested benefits.[67]

- The ***communication strategy*** surrounding the reforms has not yet been decided but is likely to affect how the reforms are perceived by

[64] Department for Work and Pensions (DWP) 2006b p 38
[65] Defined as people who are not currently participating in a pension scheme offering at least a 3 per cent employer contribution, are aged between 22 and state pension age and earning over £5,000, Department for Work and Pensions (DWP) 2006b p 27 para 62
[66] Pensions Policy Institute (PPI) 2007b
[67] Pensions Policy Institute (PPI) 2007f

individuals and what decisions they make about remaining in or opting out of pension saving.

Other factors that may not be directly under Government control, such as media coverage surrounding the introduction of Personal Accounts or the economic conditions in 2012, could also influence individuals' decisions to participate, or not, in pension saving.

Complement existing good-quality pension provision
The analysis in Chapter 3 shows that the reforms could increase annual pension contributions in some scenarios. However, the success of the reforms in this respect will depend on how employers react to the reforms.

The Government has made specific proposals that are designed to ensure the Personal Accounts complements rather than competes with existing provision. For example:

- Employers would be allowed to auto enrol their employees into an existing pension scheme rather than Personal Accounts, if the existing scheme satisfies the ***exempt scheme test***. If the exempt scheme test is simple, easily administered and sets a level playing-field with the minimum requirements for Personal Accounts, this could reduce the risk of employers switching from existing schemes to Personal Accounts.

- The Government proposes to ***allow employers who offer higher contributions or benefits to operate a three month waiting period. The intention is to support those employers who already provide or intend to provide higher value contributions or benefits by allowing them to manage their costs over a period of time rather than incurring an immediate increase in costs.***[68] A waiting period for qualifying exempt schemes could encourage and enable employers to remain with existing provision. The Government has also acknowledged that a waiting period may make it more difficult for some people to build up a pension, particularly those people who change jobs often. This means that while a waiting period could help to ensure that Personal Accounts complements rather than competes with existing provision, it may not have a positive effect on the Government's objective to increase the number of people saving for a pension.

- The Government has proposed that there will be an annual limit on the total amount of contributions that can be made into a Personal Account, of £3,600 a year.[69] The ***contribution cap*** could limit the attractiveness of Personal Accounts for employers with high earning

[68] Department for Work and Pensions (DWP) 2007 p 63 para 8
[69] The Government has said that ***the £3,600 will be based on 2005 earnings levels, and will be uprated with earnings from that point to implementation from 2012***, Department for Work and Pensions (DWP) 2007 p 94

employees and employers who wish to make higher level contributions for their employees. This may help to limit the extent of switching from existing provision into Personal Accounts.[70]

- The Government has said that initially it will not be possible to transfer pension rights that have already been built-up in existing provision to Personal Accounts. The Government has suggested that this policy could be reviewed in 2017.[71] The ***limit on transfers-in*** could reduce the impact of the reforms on existing provision, since employers would only be able to switch to Personal Accounts for new accrual, which could be less attractive than a wholesale move for existing rights and new accrual.

- The Government has said that ***There will be support for all employers during the introduction of compulsory employer contributions.***[72] Support for employers could reduce the likelihood of employers reducing their voluntary contributions in existing provision. In particular, Government has proposed that:
  - Employer contributions will be phased in over a three-year period, at the rate of 1 per cent each year
  - The employer contribution rate will be set out in primary legislation to provide employers with an assurance that the employer contribution rate will not be further increased in the future
  - The Government priority is to design the scheme and the transition phase so that burdens on employers are minimised
  - Government will consult on transitional support for the smallest businesses and whether a longer phasing period is needed.

In addition to these Government proposed policy options, industry has proposed to give existing schemes a ***quality mark***, which could help individuals identify the value of existing good-quality pension schemes. This could help both of the Government's objectives, by promoting existing good-quality schemes and increasing the value that employees attach to them.

[70] See Pensions Policy Institute (PPI) 2007c
[71] Department for Work and Pensions (DWP) 2007 p 96
[72] Department for Work and Pensions (DWP) 2006b p 16 para 36

Questions for discussion

This paper forms the background for a seminar to be held in November 2007. The seminar will explore the possible impact of the reforms on the number of people saving for a pension and on existing provision, and whether the reforms strike the right balance between the Government's two objectives.

The analysis has shown that a range of outcomes is possible in relation to the number of savers and the balance of saving between Personal Accounts and existing provision. The final outcomes to the reforms will depend on the ways that individuals and employers respond. There are a number of policy options that could help the Government to achieve these objectives.

Questions that arise from the research are:

- What are the likely employee responses? What evidence is there that they will react this way?
- What are the likely employer responses? What evidence is there that they will react this way?
- What is the 'right' balance between optimal participation and complementing existing provision?
- What policies would help to reach this balance?

Appendix 1: KiwiSaver take up assumptions

KiwiSaver is the only other national auto-enrolment pension saving scheme with an option for employees to opt out. It went live in New Zealand on 1 July 2007. While the New Zealand Government estimates for participation and early monitoring data may provide some insight into potential participation rates for Personal Accounts, there are significant design differences between the two schemes that may make meaningful comparisons difficult.

In particular, KiwiSaver will automatically enrol new employees only, which is likely to result in slower take up of KiwiSaver initially than could be expected for Personal Accounts. However, as workers change jobs the effect of this difference should lessen. KiwiSaver is arguably more generous and more flexible than Personal Accounts, which could mean that New Zealanders face greater incentives to participate. However, it does not follow that greater incentives will necessarily lead to greater rates of participation; other factors could reduce the attraction of private saving in New Zealand.

Table A1 shows that the New Zealand Government's mid range estimate assumes around half of the labour force will take up a KiwiSaver account within ten years (and that take up levels are varied by income bracket). Early monitoring data suggests that initial take up of KiwiSaver may be higher than expected.[73] It is yet to be seen whether this will result in higher take up levels over time.

Table A1:[74] New Zealand Government estimates of proportion of labour market taking up KiwiSaver tax credits after ten years (NZ dollars)

	Less than $26,000 (approx. £9,600)	$26,000 to $38,000 (approx. £9,600 to £14,100)	$38,000 and over (approx. £14,100 and over)	Total
Lower estimate	30%	45%	60%	40%
Mid estimate	35%	50%	70%	50%
High estimate	50%	70%	90%	65%

[73] KiwiSaver 2007
[74] IRD / Treasury 2007 p 19. The exchange rate used is as at November 2007.

Appendix 2: The pre-reform counterfactual

Although there is much uncertainty about what will happen in the future, the modelling assumes that private pension provision will change, even in the absence of reform. This is to reflect current trends. This appendix describes results for the pre-reform scenario, which has been used as the counterfactual when assessing the impact of the reforms.

Number of active memberships
The overall number of active memberships is assumed to remain stable over time, although with some allowance for population growth (Table A2).

Changes are assumed between different types of pension provision over time. The proportion of employees who are active members of private sector Defined Benefit (DB) schemes is assumed to reduce by two-thirds between 2003 and 2035. Around half of this reduction occurs before 2012. All of these 'leavers' are assumed to find alternative Defined Contribution (DC) provision.

PPI projections for 2006 are similar to published estimates. The ONS estimates that there were 3.35 million active members of private sector DB schemes and 1.1 million active members of private sector DC schemes in 2006.[75] The PPI projections for 2006 are 2.7 million and 1.2 million for DB and DC respectively.

Data on personal pensions is limited. There were around 4 million people (including around 1 million self-employed) contributing to a personal pension or stakeholder pension in 2004 but unlike PPI projections these estimates do not include people with a Group Personal Pension (GPP).[76]

Table A2:[77] Number of active memberships of occupational private sector pension schemes and personal pensions in the pre-reform scenario (000s)

	Funded Defined Benefit schemes[78]	Defined Contribution schemes	Personal Pensions[79]	Total number of active memberships
2006	2.7	1.2	4.8	8.6
2012	2.1	1.8	5.1	9.0
2020	1.4	2.6	5.3	9.4
2030	1.1	2.9	5.3	9.3
2040	1.1	2.9	5.4	9.4
2050	1.1	3.0	5.5	9.5

[75] Office for National Stattistics 2007
[76] PPI estimate using FRS 2004/5
[77] Figures may not add up due to rounding
[78] Excludes funded Defined Benefit schemes from the public sector
[79] Includes personal pensions, stakeholder pensions and Group Personal Pensions

Amount of contributions
The amount of contributions declines substantially between 2006 and 2030 but then remain level (Table A3).

The decline between 2006 and 2012 is principally due to the reduction in the number of active memberships in private sector Defined Benefit schemes. Contribution rates in private sector Defined Benefit scheme are assumed to remain higher than those in Defined Contribution schemes. However, contribution rates in DC schemes are assumed to increase.

PPI projections for 2006 are similar to published estimates. For example, the ONS estimates that total contributions into funded occupational pension schemes were around £44 billion in 2005 (in 2006/7 earnings terms). Allowing for around £10 billion of special contributions[80], £6 billion of contributions into Local Government Pension Scheme[81] (which are funded) and around £2-3 billion of contributions into DC schemes[82] leaves around £25 billion, which is close to the PPI projection for 2006.

For Personal Pensions, figures from HMRC and the ONS suggest that contributions to Personal Pensions were worth around £10-12 billion in 2004 (in 2006/7 earnings terms).[83] Again this compares closely with the PPI projection of around £10 billion for 2006.

Table A3:[84] Combined contributions from employers, individuals and the state into private sector pension schemes, in £ bn, in 2006/7 earnings terms

	Private sector occupational pension schemes	Personal Pensions[85]	Total
2006	25	10	40
2012	25	10	35
2020	20	15	35
2030	20	15	30
2040	20	15	30
2050	20	15	30

Figures have been rounded independently to the nearest £5 billion, so totals may not add

[80] The Pensions Regulator (TPR) / Pensions Protection Fund (PPF) 2006 p 36
[81] Local Government Pension Scheme Accounts; Table 2
[82] PPI estimate
[83] PPI estimates using figures from HMRC Table 7.10 and ONS *Pension Trends* Table 8.12
[84] PPI analysis using the Aggregate Model. Private sector occupational pension schemes includes all funded occupational pension schemes but excludes funded public sector schemes like the Local Government Pension Scheme. It also includes all personal and stakeholder pensions for employees in the private and public sectors. Contributions include employee and employer contributions, the Government contribution through tax relief and contracted-out rebates for Defined Benefit schemes but exclude special contributions made by employers to reduce deficits.
[85] Includes personal pensions, stakeholder pensions and Group Personal Pensions held by all individuals

The aggregate size of pension funds

In this paper, the aggregate size of pension funds under management includes only pre-retirement assets. These are funds that are held and invested on behalf of active or deferred members of occupational pension schemes or in personal pensions. Figures for the aggregate size of pension funds do not include post-retirement funds that are held and invested to pay the income of pensioners. DB schemes are assumed to become fully funded in the long run.

Information on the aggregate size of pension funds is limited. This is mainly because there are various types of pension funds, some of which are organised by employers while others are administered by financial institutions, and information is not collected centrally. The NAPF estimates that the size of UK pension fund assets totalled around £1.6 trillion at the end of 2006.[86] However, this estimate will include post-retirement assets. The PPI projection for the aggregate size of pension funds in 2006, which only includes pre-retirement assets, is around £1.1 trillion (Table A4).

Table A4:[87] The aggregate size of pension funds under management in the absence of reform, in £ bn, 2006/7 earnings terms

	Existing provision
2006	1,100
2012	1,100
2020	1,000
2030	850
2040	800
2050	800

[86] Table *Pension fund assets 2006* from NAPF website

[87] PPI analysis using the Aggregate Model. Includes all funded occupational pension schemes in the private sector and all group personal pensions, personal pensions and stakeholder pensions. Excludes the Local Government pension schemes. Includes only assets held in respect of individuals who have not yet begun to use their pension saving to provide an income. Figures are rounded to the nearest £50 billion.

Appendix 3: Modelling assumptions and methodology

Common set of assumptions used in the modelling

Economic assumptions:

- Price inflation is 2.5% a year
- Earnings grow by 2.0% a year in excess of prices
- Investment returns are 3.0% a year in excess of prices, reflecting a mixed portfolio of 60% equities and 40% bonds

Assumptions on Personal Accounts:

- Employees who are newly enrolled into pension saving in Personal Accounts (as opposed to existing provision) contribute the minimum amount.
- The self-employed and other individuals contribute the same as employees into Personal Accounts. This means that they contribute the equivalent of the employer amount themselves.
- Charges consist of an annual management charge of 0.3% of funds under management each year, representing the amount that the Government considers possible for Personal Accounts in the long term.[88]
- The contribution limits for Personal Accounts are assumed to be increased each year in line with the assumed growth in average earnings.

The scenarios are based on the Government's estimate that 10.8 million employees would be available for auto enrolment into pension saving in 2012.[89] The scenarios assume that around 2 million of these are already saving in a personal pension without an employer contribution. Around half of these are assumed to switch into Personal Accounts. A similar allowance is made for people who voluntarily opt in to Personal Accounts.[90]

[88] Department for Work and Pensions (DWP) 2006b
[89] Department for Work and Pensions (DWP) 2006d Figure 1.xi
[90] A broad assumption has been adopted in the modelling that one-half of the self-employed people who voluntarily opt into Personal Accounts were previously saving in a personal pension

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Contact:
Pensions Policy Institute
King's College
Kay House, 4th Floor
7 Arundel Street
London, WC2R 3DX

Niki Cleal, Director
Telephone: 020 7848 3744
Email: info@pensionspolicyinstitute.org.uk

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