National Audit Office

Report
by the Comptroller
and Auditor General

Department for Work & Pensions

Automatic enrolment to workplace pensions

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Key facts

9m

expected increase in people newly saving or saving more in qualifying workplace pensions by 2018 as a result of automatic enrolment

1.8m

expected number of employers who still need to comply with automatic enrolment duties by 2018

£1bn

budgeted costs to government of the automatic enrolment programme up to 2018 (excluding tax reliefs)

5.4 million	people automatically enrolled into new workplace pensions by the end of August 2015
58,000	employers complied with automatic enrolment requirements by the end of August 2015
8% to 14%	proportion of people opting out of automatic enrolment by the end of August 2015 (compared with an initial assumption of 28%)
99%	proportion of eligible employers declaring compliance by 1 September 2015
50%	proportion of employers yet to enrol their workforce, which have only 1 or 2 workers
500,000	increase (from 1.3 to 1.8 million) in The Pensions Regulator's estimate of the number of employers still needing to comply with automatic enrolment duties, published July 2015

Summary

1 The government faces significant challenges in ensuring that people have adequate incomes in retirement. People are living longer and fewer have been saving into workplace pension schemes than in the past. The scope for further government spending to meet shortfalls is limited. Taking into account current reforms, state pension spending is projected to increase from 5.5% of GDP in 2015 to 7.4% in 2060.

2 Pensions policy has changed significantly over the past 10 years. Following the Pensions Commission report in 2005, successive governments have: raised the state pension age; introduced more generous increases in the state pension; reformed the state pension system; introduced new flexibilities for taking out pension savings; and made enrolment into workplace pensions automatic for most workers.[1]

3 Automatic enrolment aims to reverse the long-term decline in the number of people saving into workplace pensions. Employers will have to enrol workers into a workplace pension scheme if they are working in the UK, earn more than £10,000 per year, are over 22 years old and are under state pension age. Workers can then choose to opt out, but automatic enrolment builds on evidence of inertia in people's savings decisions to encourage more people to save for retirement.

4 The government estimates that around 9 million workers will be newly saving or saving more into workplace pensions as a result of automatic enrolment by 2018. It expects annual contributions to pensions to increase by around £15 billion by 2019-20.

5 Three organisations are primarily responsible for introducing automatic enrolment:

- The Department for Work & Pensions (the Department) pays state pensions and sets wider pensions policy. It is responsible for designing automatic enrolment policy and legislation, and for the overall management of the programme.
- The Pensions Regulator is one of the Department's arm's-length bodies and regulates workplace pension schemes. It provides guidance for employers and scheme providers and is responsible for monitoring and enforcing of compliance with automatic enrolment rules.
- The National Employment Savings Trust (NEST) Corporation is a non-departmental public body, which runs the NEST pension scheme, a defined contribution pension scheme with a public service obligation to accept any employer.

1 The Pensions Commission, *A New Pension Settlement for the Twenty-First Century: The Second Report of the Pension Commission*, 2005. Available at: http://webarchive.nationalarchives.gov.uk/+/http:/www.dwp.gov.uk/publications/dwp/2005/pensionscommreport/main-report.pdf

6 Automatic enrolment began in October 2012, with larger employers joining the programme first. Between 2015 and 2018, the Department will extend this to the smallest employers, including those with only 1 worker. The Department is also phasing in increases to the minimum level of contributions from 2017.

The scope of this report

7 Automatic enrolment is an innovative approach to increasing retirement incomes and builds on evidence of inertia in people's savings decisions. The policy was developed in response to the recommendations of an independent commission in 2005. Its more detailed design was independently reviewed in 2010.[2] Parliament has examined automatic enrolment in detail and the overall policy has consistently received cross-party support.

8 The success of automatic enrolment will depend not just on an innovative and well-tested design, but also on how the programme is implemented. This could affect savings behaviour as well as the costs – to both government and employers – of rolling out this major programme. In this report we therefore look at how the Department, The Pensions Regulator and NEST have implemented automatic enrolment, including:

- progress in implementing automatic enrolment so far (Part One);
- how the Department and its arm's-length bodies have managed the programme (Part Two); and
- the remaining challenges in implementing the programme (Part Three).

9 The success of automatic enrolment will also depend on how it interacts with wider changes to policy. In our July 2013 report *Government interventions to support retirement incomes*, we said the government needed to take a more holistic view of measures to support retirement incomes and gain a better understanding of how they interact.[3] Pensions policy has continued to change and in Part Three of this report we consider some of the implications for automatic enrolment. We plan to develop these themes further in future work on pensions reform.

2 P. Johnson et al, *Making automatic enrolment work: A review for the Department for Work and Pensions*, Cm 7954, October 2010. Available at: www.gov.uk/government/uploads/system/uploads/attachment_data/file/214585/cp-oct10-full-document.pdf

3 Comptroller and Auditor General, *Government interventions to support retirement incomes,* Session 2013-14, HC 536, National Audit Office, July 2013.

Key findings

Progress to date

10 **Larger employers have now introduced automatic enrolment**. The Pensions Regulator reports that 58,000 employers have now complied with their automatic enrolment duties: retaining and expanding existing qualifying pension schemes; introducing new automatic enrolment schemes; or confirming that they have no eligible workers. Large and medium-sized employers account for around 15 million eligible workers (75% of all eligible workers in the UK) (Paragraphs 1.11, 1.12 and Figure 4).

11 **More people are saving into workplace pensions**. Employers enrolled 5.4 million workers into new workplace pensions by the end of August 2015. Between April 2012 and April 2014, the overall proportion of eligible workers saving into a workplace pension increased by 15 percentage points to 70% (Paragraph 1.13 and Figure 5).

12 **Opt-out rates have been much lower than expected**. The Department originally estimated that around 28% of people would opt out of workplace pensions. Various estimates of actual opt-out rates show they have been between 8% and 14%. The Department has now lowered its overall estimate of opt-out rates for the programme to 15%. It initially expected 7 million people to be newly saving or saving more in workplace pensions as a result of automatic enrolment. It has now increased its estimate to 9 million (Paragraphs 1.14, 1.15 and Figure 1).

13 **Employer compliance has also been higher than expected**. Of those employers expected to declare their compliance with automatic enrolment duties by 1 September 2015, 99% have done so. Very few cases have proceeded to later stages of enforcement. Of those that have, 77% of employers become compliant following interventions by The Pensions Regulator (Paragraph 1.16 and Figure 15).

14 **Several private providers offer qualifying pensions for automatic enrolment, in addition to NEST**. The Department established NEST with the aim of providing any employer with a low-cost, quality pension scheme to comply with their automatic enrolment duties. In addition to NEST, several private providers offer automatic enrolment products to employers (Paragraph 1.17 and Figure 7).

15 **The programme is currently on budget**. The Department originally expected implementation of the programme to cost £1.1 billion. It reduced this to £1 billion in its 2015 estimate, largely because of reduced costs of The Pensions Regulator. Programme spending is on profile at £554 million to the end of March 2015, which is around half of total budgeted costs. The Department estimates that employers will spend £500 million setting up automatic enrolment and £140 million each year on administering automatic enrolment (Paragraphs 1.18, 1.19 and Figures 1 and 8).

Managing the programme

16 The Department set clear aims for automatic enrolment. The organisations involved in implementing the programme have a consistent understanding of its aims – to increase the number of people saving and the level of pensions savings – as well as supporting critical success factors. This has allowed the Department, The Pensions Regulator and NEST to consult widely with stakeholders and introduce several changes to processes and rules to reduce risks while protecting their core objectives (Paragraphs 2.2 to 2.6 and Figure 9).

17 The Department, The Pensions Regulator and NEST have identified and tested critical assumptions about behaviour. The Department set up a joint assumptions working group to review and update the programme's assumptions, such as opt-out and compliance rates. The Department, The Pensions Regulator and NEST have assessed the impacts of variations in outcomes compared to original assumptions on their plans and budgets. The Pensions Regulator and NEST have also reviewed operational assumptions for implementing automatic enrolment, but rely on contractors to handle changes in behaviour such as employer compliance (Paragraphs 2.7 to 2.11 and Figure 6).

18 The automatic enrolment programme team has been small and stable. The Department, The Pensions Regulator and NEST have worked closely together to introduce the programme, with few changes in key personnel over the past 5 years. Although there have been inherent risks of confusing responsibilities, the three bodies have a clear understanding of their roles and developed stable working relationships. All the programme team members we interviewed said this long-term stability was a major contributing factor to the success of the programme so far (Paragraphs 2.12 to 2.16 and Figure 11).

19 The Department has developed automatic enrolment over a long period and introduced it in stages. The progressive roll-out to employers and phased increase of minimum contribution rates have reduced risks and allowed time to test assumptions and refine processes. The Department is planning to review the programme in 2017 (Paragraphs 2.21 to 2.26 and Figure 12).

Future challenges

20 The Department is now rolling out automatic enrolment to small employers, who pose new challenges for the programme. The profile of employers affected by automatic enrolment is now changing dramatically. Small employers are expected to have different requirements and responses to automatic enrolment. They will also create greater operational challenges as volumes increase (Paragraph 3.2 and Figure 13).

21 **Operational risks are significant and expected volumes have increased**. While most eligible workers work for larger employers and have already enrolled, the vast majority of employers still have to start automatic enrolment. The Pensions Regulator recently increased its estimate of the number of employers by 37% to 1.8 million. This was because of changes in its assumptions about the rates of entry and exit of new employers. While around one-third of employers may not have eligible workers, the volume of employers creates significant pressure on operations. The Pensions Regulator plans to get a regular feed from HM Revenue & Customs' (HMRC) Real-time Information (RTI) system.[4] This should allow it to improve its targeting of employers with eligible workers (Paragraphs 2.20, 3.3 to 3.7 and Figure 14).

22 **The Department, The Pensions Regulator and NEST are simplifying processes for small employers**. Our review of contractors' operations highlighted the need for simplification of administrative and compliance processes, which will come under increasing pressure as volumes increase. The Pensions Regulator and NEST have designed websites and online tools to minimise demand on call centres. These reflect the experience they have gained with larger employers and early feedback from smaller employers (Paragraphs 3.8 and 3.10 to 3.11 and Figure 15).

23 **The longer-term success of the programme will depend on its ability to stimulate higher retirement incomes**. Awareness has increased and very early opt-out rates in smaller employers are encouraging. Translating broader pensions enrolment into higher retirement incomes will depend on a number of factors including: maintaining enrolment when minimum contributions increase; encouraging higher optional rates of contributions; ensuring that fees and charges are appropriate; establishing a simple and transparent mechanism for handling multiple pensions pots; and embedding clear and effective governance of pensions schemes. The Department will also need to monitor the way the programme interacts with wider reforms (Paragraphs 3.12 to 3.21 and Figures 16 and 17).

24 **The role of NEST within the pensions market is still evolving**. Revenues at NEST and other pension providers are highly uncertain and are affected by greater than expected private provision, extensions of start dates and lower real wage increases. NEST is funded by a government loan and it will grow its funds under management as enrolment and contributions increase. It will need to grow funds under management significantly before it can be self-supporting (Paragraphs 3.22 to 3.26).

4 Real-time Information (RTI) is an HMRC led initiative which changes the way UK employers make Pay-As-You-Earn (PAYE) submissions. It requires all employers not only to notify HMRC of their liability to PAYE at the time or before they make payment to their employees, operate PAYE at the time of payment and pay duty each month (or quarter for small employers), but also to provide details about payments and deductions for individuals in-year rather than just at the end of the year.

Conclusion on value for money

25 Large and medium-sized employers have successfully introduced automatic enrolment. The Department, The Pensions Regulator and NEST have worked well to design the programme and to engage with providers and other stakeholders in developing rules and processes. By increasing the number of people saving in workplace pensions, and providing a crucial first step to increasing retirement savings, the automatic enrolment programme has so far delivered value for money. Looking ahead, early indications suggest the programme is also on track to deliver value for money in improving retirement incomes in the longer term.

26 But there are significant risks. In the short term, smaller employers are likely to behave differently in response to the administrative requirements of automatic enrolment. The volume of smaller employers will impose significant pressures on operations. In the longer term, the Department will need to ensure that more widespread enrolment translates into higher retirement incomes as it tackles remaining questions about the design of automatic enrolment, wider reforms and market development.

Recommendations

27 In the shorter term, The Pensions Regulator should ensure it is able to manage the operational challenges of introducing automatic enrolment for small employers. It should also:

a speed up the introduction of information from HMRC's RTI system to improve its targeting of employers and compliance monitoring, for example by checking declarations of compliance;

b work with its contracted provider to review and develop further contingency measures to reduce pressures on operations; and

c together with the Department, strengthen an integrated intelligence function about user behaviour, building on its own customer insight work and drawing in data from providers and NEST.

28 To ensure the longer-term success of automatic enrolment, the Department should continue to work with The Pensions Regulator and NEST to encourage and protect savings for retirement. In particular, it should:

d set out the scope of the review in 2017 for consultation to ensure there are appropriate measures in place to evaluate the achievement of long-term aims and objectives;

e assess the impact of wider pensions policies, including pensions flexibilities, on automatic enrolment and monitor emerging trends and concerns, paying particular attention to the responses of employers and scheme trustees; and

f review NEST's role in the market and its impact on competitive restrictions, and continue to review the long-term sustainability of the current funding arrangement.