

<b>Title:</b> <b>Short Service Refunds Impact Assessment</b> <b>IA No:</b> DWP0023 <b>Lead department or agency:</b> DWP <b>Other departments or agencies:</b>	<b>Impact Assessment (IA)</b>
	<b>Date:</b> December 2011
	<b>Stage:</b> Final
	<b>Source of intervention:</b> Domestic
	<b>Type of measure:</b> Primary legislation
	<b>Contact for enquiries:</b> Natalie Weddell, 020 7449 7295

<b>Summary: Intervention and Options</b>	<b>RPC:</b> AMBER
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Cost of Preferred (or more likely) Option				
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, One-Out?	Measure qualifies as
£90m-£120m (cost)	£520m-£920m (cost)	£21m-37m (cost)	Yes	IN

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

Differences between occupational and workplace pension schemes' treatment of short term workers could reduce the savings of some individuals. In an occupational (ie trust based) pension scheme, members who leave the scheme within two years of joining can be offered a refund of their contributions or a cash transfer to another scheme, with the default option being a refund. Employer's contributions remain in the scheme, allowing them to offset future contribution or administration costs. However, this is not possible in workplace personal (ie contract based) pension schemes. Around 20,000 private sector DC pension pots were refunded in 2009. The disparity in treatment of similar pension products seems likely to lead to a shift in the market towards occupational pension schemes, possibly leading to 50,000-80,000 refunds per year after automatic enrolment, with younger low to moderate earners most at risk of missing out on opportunities to increase their retirement provision. Short service refunds are contrary to the policy objective of automatic enrolment which is to get the vast majority of working people saving in a pension.

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

Our policy objective is to promote persistent pension savings and promote good retirement incomes for individuals. Automatic enrolment will bring millions of individuals into pension schemes and help them build a good retirement income, but we need to make sure the current regulatory framework support this. Current short service rules for occupational schemes give employers a strong incentive to exploit regulatory differences, at a cost to short term workers who could fail to build their pension savings because they automatically receive a refund of their contributions (and lose employer and state contributions) when they move jobs. The effect of the changes will mean that these individuals retain their and their employers' pension contributions in a pension.

**What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)**

This Impact Assessment considers five options: 1. Do nothing. 2. Change the default action – make the refund an active choice, applicable from 2014. 3. Change the default action from 2017. 4. Abolish short service refunds – schemes would no longer be able to offer short service refunds, applicable from 2014. 5. Abolish short service refunds from 2017. The preferred option is abolition in 2014 (option 4) as only this fully prevents market distortions from impeding some individuals' access to retirement saving opportunities.

<b>Will the policy be reviewed? It will be reviewed. If applicable, set review date:</b> June 2017					
Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.		<b>Micro</b> Yes	<b>&lt; 20</b> Yes	<b>Small</b> Yes	<b>Medium</b> Yes
What is the CO2 equivalent change in greenhouse gas emissions? (Million tonnes CO2 equivalent)		<b>Traded:</b> N/A		<b>Non-traded:</b> N/A	

***I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.***

Signed by the responsible Minister:  Date: 19/10/11

# Summary: Analysis & Evidence

Policy Option 1

Description: Do nothing

## FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2011	Time Period Years 39	Net Benefit (Present Value (PV)) (£m)		
			Low: 0	High: 0	Best Estimate: 0

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0	0	0	0
High	0		0	0
Best Estimate	0		0	0

Description and scale of key monetised costs by 'main affected groups'

N/A

Other key non-monetised costs by 'main affected groups'

N/A

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	0	0	0
High	0		0	0
Best Estimate	0		0	0

Description and scale of key monetised benefits by 'main affected groups'

N/A

Other key non-monetised benefits by 'main affected groups'

N/A

Key assumptions/sensitivities/risks

N/A

Discount rate (%)

3.5 / 3

## BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 0	Benefits: 0	Net: 0		

# Summary: Analysis & Evidence

# Policy Option 2

Description: Require active choices from members to issue refunds from 2014

## FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2011	Time Period Years 39	Net Benefit (Present Value (PV)) (£m)		
			Low: -80	High: -100	Best Estimate: -90

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0.1	70	1,400
High	1.5	90	1,800
Best Estimate	0.8	80	1,600

### Description and scale of key monetised costs by 'main affected groups'

Reductions in refund volumes reduce the transfers of wealth from individuals' pension savings to employers', individuals' and the state's cash balances. There are also resource impacts for pension providers whose revenues and costs rise with the savings increase. See paragraph 12 for discussion.

#### Annual averages in 2011 price terms (£m)

**Transfers:** Employer contributions: 20; individual contributions: 40-50; tax relief: 10.

**Costs:** Pensions provider costs: 10.

### Other key non-monetised costs by 'main affected groups'

N/A

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	70	1,300
High	0	90	1,700
Best Estimate	0	80	1,500

### Description and scale of key monetised benefits by 'main affected groups'

#### Annual averages in 2011 price terms (£m)

**Transfers:** Individual pension right accruals: 60-80

**Benefits:** Pensions provider revenues: <5

### Other key non-monetised benefits by 'main affected groups'

We have not captured here the impact of corporation tax relief on mitigating employer costs or of the 'social welfare benefits' which describe the additional benefit derived from individuals benefiting from their pension accruals at a time when their incomes are generally lower than when the contributions were made. Both are difficult to calculate reliably at this level and their omission ensures that we do not understate the burden the policy imposes on employers nor overstate its benefit to individuals.

### Key assumptions/sensitivities/risks

Discount rate (%)

3.5

This analysis assumes that changes to short service refund rules in 2014/17 suffice to discourage their proliferation even in the period between the onset of automatic enrolment duties and changes to refund rules, in order not to underestimate industry costs. As such, any increase in refunds results from members' automatic enrolment into schemes already issuing refunds to individuals leaving with short service.

## BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 24	Benefits: 3	Net: 21 <sup>1</sup> (cost)	Yes	IN

<sup>1</sup> While this is the net impact of the policy, the DWP's 'IN' score should increase by only £9m; see paragraph 43 for discussion

# Summary: Analysis & Evidence

# Policy Option 3

Description: Require active choices from members to issue refunds from 2017

## FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2011	Time Period Years 39	Net Benefit (Present Value (PV)) (£m)		
			Low: -80	High: -100	Best Estimate: -90

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0.1	70	1,300
High	1.5	90	1,700
Best Estimate	0.8	80	1,500

### Description and scale of key monetised costs by 'main affected groups'

#### Annual averages in 2011 price terms (£m)

**Transfers:** Employer contributions: 20; individual contributions: 40-50; tax relief: 10.

**Costs:** Pensions provider costs: 10.

### Other key non-monetised costs by 'main affected groups'

N/A

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	70	1,200
High	0	80	1,600
Best Estimate	0	70	1,400

### Description and scale of key monetised benefits by 'main affected groups'

#### Annual averages in 2011 price terms (£m)

**Transfers:** Individual pension right accruals: 60-80

**Benefits:** Pensions provider revenues: <5

### Other key non-monetised benefits by 'main affected groups'

We have not captured here the impact of corporation tax relief on mitigating employer costs or of the 'social welfare benefits' which describe the additional benefit derived from individuals benefiting from their pension accruals at a time when their incomes are generally lower than when the contributions were made. Both are difficult to calculate reliably at this level and their omission ensures that we do not understate the burden the policy imposes on employers nor overstate its benefit to individuals.

### Key assumptions/sensitivities/risks

Discount rate (%) 3.5 / 3

This analysis assumes that changes to short service refund rules in 2014/17 suffice to discourage their proliferation even in the period between the onset of automatic enrolment duties and changes to refund rules, in order not to underestimate industry costs. As such, any increase in refunds results from members' automatic enrolment into schemes already issuing refunds to individuals leaving with short service.

## BUSINESS ASSESSMENT (Option 3)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 22	Benefits: 3	Net: 19 <sup>2</sup> (cost)	Yes	IN

<sup>2</sup> While this is the net impact of the policy, the DWP's 'IN' score should increase by only £8m; see paragraph 43 for discussion

# Summary: Analysis & Evidence

# Policy Option 4

**Description:** Abolish short service refunds from 2014

## FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2011	Time Period Years 39	Net Benefit (Present Value (PV)) (£m)		
			Low: -90	High: -120	Best Estimate: -100

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0.1	80	<b>1,600</b>
High	1.5	140	<b>2,800</b>
Best Estimate	0.8	110	2,200

### Description and scale of key monetised costs by 'main affected groups'

#### Annual averages in 2011 price terms (£m)

**Transfers:** Employer contributions: 20-40; individual contributions: 40-80; tax relief: 10

**Costs:** Pensions provider costs: 10.

### Other key non-monetised costs by 'main affected groups'

N/A

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	80	<b>1,500</b>
High	0	140	<b>2,700</b>
Best Estimate	0	110	2,100

### Description and scale of key monetised benefits by 'main affected groups'

#### Annual averages in 2011 price terms (£m)

**Transfers:** Individual pension right accruals: 70-130

**Benefits:** Pension provider revenues: <5-10

### Other key non-monetised benefits by 'main affected groups'

We have not captured here the impact of corporation tax relief on mitigating employer costs or of the 'social welfare benefits' which describe the additional benefit derived from individuals benefiting from their pension accruals at a time when their incomes are generally lower than when the contributions were made. Both are difficult to calculate reliably at this level and their omission ensures that we do not understate the burden the policy imposes on employers nor overstate its benefit to individuals.

Key assumptions/sensitivities/risks

Discount rate (%) 3.5 / 3

This analysis assumes that changes to short service refund rules in 2014/17 suffice to discourage their proliferation even in the period between the onset of automatic enrolment duties and changes to refund rules. As such, any increase in refunds results from members' automatic enrolment into schemes already issuing refunds to individuals leaving with short service.

## BUSINESS ASSESSMENT (Option 4)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 33	Benefits: 5	Net: 29 <sup>3,4</sup> (cost)	Yes	IN

<sup>3</sup> While this is the net impact of the policy, the DWP's 'IN' score should increase by only £12m; see paragraph 43 for discussion

<sup>4</sup> Numbers may not sum due to rounding

# Summary: Analysis & Evidence

# Policy Option 5

**Description:** Abolish short service refunds from 2017

## FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2011	Time Period Years 39	Net Benefit (Present Value (PV)) (£m)		
			Low: 80	High: 110	Best Estimate: 100

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0.1	80	1,500
High	1.5	130	2,600
Best Estimate	0.8	110	2,000

### Description and scale of key monetised costs by 'main affected groups'

#### Annual averages in 2011 price terms (£m)

**Transfers:** Employer contributions: 20-30; individual contributions: 40-80; tax relief: 10

**Costs:** Pensions provider costs: 10.

### Other key non-monetised costs by 'main affected groups'

N/A

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	70	1,400
High	0	130	2,500
Best Estimate	0	100	2,000

### Description and scale of key monetised benefits by 'main affected groups'

#### Annual averages in 2011 price terms (£m)

**Transfers:** Individual pension right accruals: 70-120

**Benefits:** Pension provider revenues: <5-10

### Other key non-monetised benefits by 'main affected groups'

We have not captured here the impact of corporation tax relief on mitigating employer costs or of the 'social welfare benefits' which describe the additional benefit derived from individuals benefiting from their pension accruals at a time when their incomes are generally lower than when the contributions were made. Both are difficult to calculate reliably at this level and their omission ensures that we do not understate the burden the policy imposes on employers nor overstate its benefit to individuals.

### Key assumptions/sensitivities/risks

Discount rate (%)

N/A

This analysis assumes that changes to short service refund rules in 2014/17 suffice to discourage their proliferation even in the period between the onset of automatic enrolment duties and changes to refund rules. As such, any increase in refunds results from members' automatic enrolment into schemes already issuing refunds to individuals leaving with short service.

## BUSINESS ASSESSMENT (Option 5)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 30	Benefits: 4	Net: 25 <sup>5,6</sup> (cost)	Yes	IN

<sup>5</sup> While this is the net impact of the policy, the DWP's 'IN' score should increase by only £10m; see paragraph 43 for discussion

<sup>6</sup> Numbers may not sum due to rounding

## Short Service Refunds Call for Evidence

1. In June 2011 the DWP published a response to its call for evidence on the regulatory differences between occupational and workplace personal pensions.<sup>1</sup> The call for evidence looked at areas of regulatory differences that may not be consistent with the aims of automatic enrolment. We highlighted short service refunds as an area of concern and sought stakeholder views on whether the rules should remain in place. Some stakeholders argued that short service refund rules should be retained because this afforded occupational schemes a cost effective way to manage early leavers and reduce numbers of small pots; others called for the abolition of these rules because they case individuals to lose out on opportunities to build their pension savings. There was a broad consensus among stakeholders that if Government were to pursue abolition, it should look at ways to improve the transfer process so that pension schemes are not unduly burdened with the large volumes of small pension pots that seem likely to follow from automatic enrolment.
2. The call for evidence showed that short service refunds would be a key factor amongst a range of factors influencing scheme choice, and that the availability of short service refunds would be more significant for larger employers, especially those with high staff turn-over. In general, consumer groups preferred abolition of short-service refunds, pension providers had mixed views and employer groups were in favour of the retention of short-service refunds. In response to the call for evidence, government concluded there was not compelling evidence to retain short service refunds.

## Preferred Option

3. The Government's decision is that short service refunds should not continue in their current form, as the overall loss of pension savings is at odds with our goal of raising retirement incomes. Our intention is to abolish the rules at the earliest legislative opportunity. According to current timetables this will likely be achieved by 2014, but we have also considered a later ban (in 2017) in our analysis. We believe that only a ban (as opposed to requiring active decisions by savers, as in options 2 and 3) can fully prevent market distortions from impeding short service employees' access to savings opportunities enjoyed by the rest of the eligible population.
4. We are conscious of the impact on the pensions industry of managing increased volumes of small pots that are likely to result from automatic enrolment. Government therefore intends to work with the pensions industry, occupational schemes and consumer groups to design a workable solution to reduce the number of small pots in the system and to improve transfer arrangements. This work will begin with a consultation paper later in 2011 to consider possible options.

## Evidence Base (for summary sheets)

### Problem under consideration

5. From October 2012 employers will be required to automatically enrol all their eligible workers into a qualifying pension scheme. These workplace pension reforms are designed to overcome the decision-making inertia that characterises many individuals' attitudes to saving. Automatic enrolment and a minimum employer contribution will transform workplace pension saving. We estimate that between five and eight million people will be newly saving in a workplace pension scheme as a result of the reforms.<sup>2</sup>
6. However, current rules on early leavers in occupational pension schemes risk undermining to this goal. Short service refund rules give individuals who leave an occupational pension scheme with at least 3 months, but less than 2 years, of pensionable service the right to:
  - a. the right to a refund of their contributions (a short service refund), or
  - b. a cash transfer sum.<sup>3</sup>

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<sup>1</sup> See "Government response to Regulatory differences between occupational and workplace personal pensions: Call for evidence to prepare for automatic enrolment", [www.dwp.gov.uk/docs/personal-pensions-consultation-response.pdf](http://www.dwp.gov.uk/docs/personal-pensions-consultation-response.pdf)

<sup>2</sup> DWP Pension Bill 2011, Impact Assessment of the Workplace Pension Reforms, [http://www.dwp.gov.uk/policy/pensions\\_reform/](http://www.dwp.gov.uk/policy/pensions_reform/)

<sup>3</sup> See section 101 of the Pensions Schemes Act 1993

7. A transfer into another pension scheme includes both the member's contributions and the employer's contribution, but if the member takes a short service refund the employer's contributions remain in the scheme and can be used by employers to offset future pension contribution costs (or cover administrative costs). Schemes are able to give a refund as a default if the member does not make an active choice.<sup>4</sup> Workplace personal pensions have immediate vesting: they cannot offer these refunds.
8. Currently around 20,000 short service refunds are taken from defined contribution occupational pension schemes each year. Without changes to the regulatory regime we anticipate this increasing to 50,000-80,000, which means that some individuals will miss out on opportunities to increase their pension savings, and will miss out on employer contributions.

## Rationale for intervention

9. Short service refund rules distort the pensions market: they provide an incentive for employers to use occupational (trust based) pension schemes as a means to recycling employer contributions and reducing costs. In conversations with NEST some employers have already signalled a strong intention to use multi-employer trust based pension schemes (Master Trusts) as a means of exploiting this. Providers have approached the DWP to caution about providers and intermediaries marketing this angle of Master Trusts. While this in itself is not a concern for government, the existence of short service refunds combined with an increasingly mobile labour market gives rise to concern about significant reductions in pension savings.
10. Individuals who are employed for short periods (less than 24 months) are twice as likely to be young (under 30 years old) and low to moderate earners as the rest of the population<sup>5</sup>. People with these characteristics are a key part of DWP's target group for automatic enrolment. The risk of short-service refund rules reducing their likelihood of saving is a concern and undermines the goals of automatic enrolment.

## Policy objective

11. Changing short service refunds fulfils a number of policy objectives:
  - It complements the aims of automatic enrolment by facilitating more people saving more for their retirement;
  - Individuals automatically enrolled into occupational schemes will be able to continually build their pension savings and benefit from their employer's contribution (which they would forego if they took a refund);
  - Ensuring that the regulatory framework underpinning the private pensions system supports automatic enrolment and persistent pensions savings in the long term; and
  - Minimising market distortions caused by the application of different regulatory frameworks to otherwise similar pension products (eg Master Trusts and Group Personal Pensions).

## Analytical Approach and Key Assumptions

12. When a pension pot is refunded:
  - a. An employee loses pension assets, while the employee, the employer<sup>6,7</sup> and the State gain cash: the employee and the employer each receives a refund of their contributions, while the state receives a refund of the tax relief originally applied to the contributions. The sum of the gains is equal to the loss, hence this transaction is a 'transfer' with zero net impact.
  - b. A pension provider foregoes the cost of maintaining a pension pot and the benefit of any charge revenues on it; the provider also incurs the one off cost of processing the refund.

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<sup>4</sup> See section 101AB of the Pension Schemes Act 1993

<sup>5</sup> DWP analysis of the Labour Force Survey, Q3 2007 – Q2 2009

<sup>6</sup> In terms of the employer, the contributions remain in the scheme and can be used to off-set future contributions or administration cost. While this is not direct cash flow, in practice this refund pot can free up money for an employer.

<sup>7</sup> For the purposes of this note, 'employer' refers to the sponsoring employer of a pension scheme. The sum of employers plus the sum of pension providers gives the 'industry impact' in the summary sections of this IA.



## Transfer impacts

13. We have assumed that employers newly using schemes that offer short service refunds will make contributions at the minimum level. Analysis of the 2010 Labour Force Survey suggests that, given tenure and pay of eligible employees, the average pension pot for employees leaving such an employer with short service will be around £1,000. Where employers already use schemes that offer short service refunds, we assume that the value of those refunds will be similar to their current level, which a combination of HMRC data and results from the Occupational Pension Schemes Survey 2009 suggests will be around £2,000.
14. For the period 2012-2017, during which employer duties are staged and phased in, we have adjusted the pension pot size on a pro rata basis for the total contribution rate for large employers<sup>8</sup>.
15. We assume that employers' and employees' "share" of pots refunded is commensurate with their respective default contribution rates, so where the default rate is 8%, of which 5 percentage points comes from the employee, we assume that the employee will receive £625 of a £1,000 refund (which is then taxed at the basic rate) and the employer £375.

## Resource impacts

16. The resource impact of a refund is borne by the pension provider, who incurs a fixed annual cost for administering each pension pot, a fixed one-off cost for processing a refund and collects revenues from charges levied as a proportion of the fund under management<sup>9</sup>. When providers process a refund, therefore, they incur a transaction cost and forsake both future administration costs and future charge revenues. We evaluate this future stream of costs and revenues using a 25-year<sup>10</sup> net present value (NPV) statistic.
17. In order to evaluate both the stream of future charge revenues we have to make assumptions about fund values and growth and about charge rates and structures. Consistent with previous analyses, we assume that:
  - a. Funds grow by 7% (nominal, before charges) per year
  - b. Prices rise by 3.2% per year
18. Following informal engagement by the DWP with representatives of the pensions industry, we assume an 11% nominal discount rate<sup>11</sup> broadly represents rates used by pension providers and that the annual cost of administering an individual's pension pot is £25. As providers differed significantly in the admin costs they reported, we have also considered the impact of options when administration costs are £15 per pot per year. We also acknowledge that particular types of pension may be characterised by costs above this level, but believe these costs are commensurate with equivalent (intangible) benefits such as employee satisfaction, which must in a competitive market more-than-compensate for their cost (or employers would not use them). It is therefore reasonable to assume that the higher costs and benefits 'cancel one another out'.

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<sup>8</sup> Advice from pensions industry representatives was that only employers of 1,000 or more employees would see sufficient benefits from short service refunds for them to affect scheme choices.

<sup>9</sup> Other charge structures and approaches exist, but for simplicity we assume the predominant charge structure is universal: the majority of employees affected by short service refunds under Option 1 (Do Nothing) will be in schemes where employees bear the full charge burden. In cases where employers cover administration charges through a per member head charge we anticipate a total impact of less than £15m per annum.

<sup>10</sup> Labour Force Survey analysis suggests that the median term until retirement for individuals whose employment tenure is below 24 months is around 25 years.

<sup>11</sup> The 11% discount is used only for industry accounting; in other sections we use the Green Book standard discount rate of 3.5%

19. We also assume a uniform annual charge across all providers of 0.5% of funds under management. This is at the lower end of the range of charges in workplace pension schemes established by responses to the DWP charges survey<sup>12</sup>. By taking the lower end of this range we make our analysis more conservative, and more likely to overstate than understate the impact on pension providers of policies that restrict short service refunds. On this basis:
- the NPV to a provider of retaining a £1,500 pension pot<sup>13</sup> when annual administration costs are £25 is -£140 (i.e. a loss);
  - the NPV of retaining a £1,500 pot when annual administration costs are £15 is -£50 (ie a loss);
  - the NPV of refunding a pot is -£50 (i.e. the one off cost of refunding it)
20. We have assumed that pension provider impacts persist for the entirety of the period under consideration (2012 to 2050). This implicitly assumes that prices charged to individuals will neither rise when provider costs increase nor fall when provider costs decrease. As price competition in this market is impeded by the fact that employers choose schemes and employees pay the price (unless employers opt to do so on their behalf, either in full or in part) it is therefore possible that employers will not re-visit scheme choices even when employees might be able to secure a cheaper pension elsewhere.

### **Labour market adjustment**

21. As discussed in Workplace Pension Reforms Impact Assessment 1b (DWP00001b) it is appropriate in the context of pension reforms to assume that employers will be able to offset some of the costs associated with increased pension contributions through suppressed wage growth. Allowing ten years for adjustment to take place, and limiting this adjustment to 50% of employers' costs, strikes the appropriate balance between accommodating this effect and constraining it sufficiently so as to minimise the risk of understating employer impacts of the legislation.
22. The impact of this is that over time, although in the example in paragraph 15 the employer and employee would continue to contribute £325 and £675 respectively to a £1000 pension pot, after ten or more years wage growth would have been suppressed such that employees would be paid £162.50 less than would have been the case had reforms never been enacted. This brings the de facto employee contribution up to £837.50 and the employer contribution to £162.50.

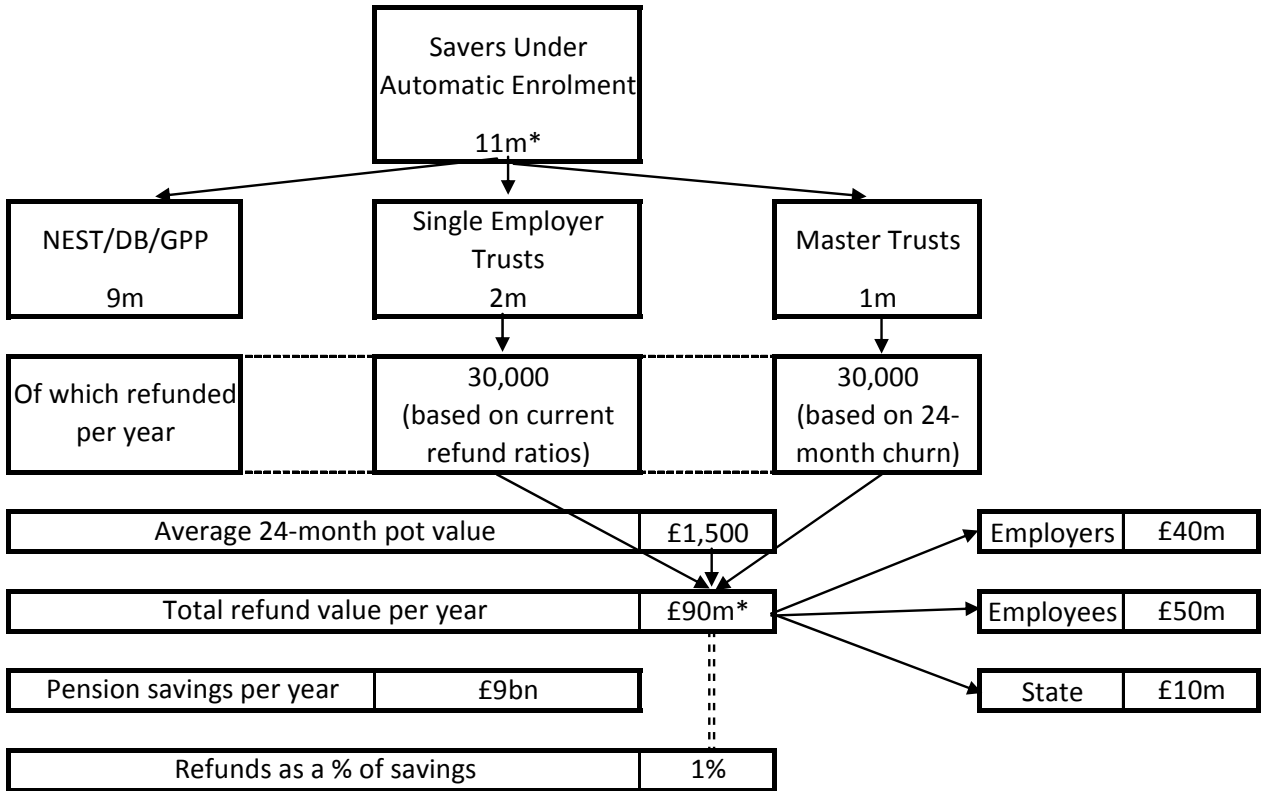
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<sup>12</sup> DWP Research Report No. 630: Charging Levels and Structures in Money-Purchase Pension Schemes: Report of a quantitative survey.

<sup>13</sup> The average value of refunded pots

## Refund volumes

Figure 1 – Annual refund volumes and aggregate value



\*numbers may not sum due to rounding

23. The DWP regularly publishes forecasts of volumes of savers under automatic enrolment. This analysis is based principally on the Annual Survey of Hours and Earnings. We have used these forecasts (specifically where they address the impact of short service refund rules) to derive a range of possible short service refund volumes. The mid-point of each of the ranges used is shown in Figure 1.
24. For DC trust arrangements analogous to current DC trust provision, we assume that rates of refunds will be the same as they are currently (around 1.5% of private sector DC trust memberships is refunded each year<sup>14</sup>). This leads to around 30,000 refunds per year from a base of around 2 million members.
25. For the increases in DC trust participation that can be attributed to variations in the permissibility of short service refunds we assume that 6% will receive short service refunds in a year (this is the proportion of employees of large<sup>15</sup> private sector employers who leave with short service in a given year, according to the Labour Force Survey<sup>16</sup>).
26. Adding these two sets of refund volumes together gives us a range of refund volumes for the 'do nothing' option of 50,000-80,000 per year, of which 20,000-40,000 are associated with schemes that previously offered short service refunds and the remainder with 'employer response' to legislation on short service refunds. This is a significant increase on the existing number of refunds made, reflecting the expansion in membership within existing schemes due to auto-enrolment, as well as the anticipated expansion of membership within schemes offering short service refunds if no action is taken.

<sup>14</sup> Occupational Pension Schemes Survey 2009

<sup>15</sup> With 500 or more employees – engagement with intermediaries suggests that short service refunds will only affect decisions about which scheme to use for large employers.

<sup>16</sup> Based on analysis of the 2010 Labour Force Survey, Q1-Q4.

27. Under scenarios where short service refund rules are changed, we have assumed that the only increase in short service refunds is that associated with 'natural' increases in membership (ie as a consequence of automatic enrolment) of schemes that currently offer short service refunds. When short service refunds are abolished from 2014/2017, we assume that the 'naturally' expanded volume of refunds continues until 2014/2017, whereupon they cease (in the case of abolition – options 4 and 5) or fall off sharply (in the case of requiring an active decision – options 2 and 3). There is no evidence about how many schemes would choose to offer short service refunds prior to abolition in these scenarios, and hence it has been assumed that no employers choose to offer them during the period prior to abolition. This leads to the largest possible burden on employers, and ensures the impact on business is not understated.
28. When schemes are only able to refund contributions of members who actively opt to receive a refund, we assume that 20%-50% will elect to receive one: the decision to take a refund of contributions upon leaving an employer is directly analogous to the decision to opt out of pension savings (in both cases forsaking employer contributions) upon joining an employer. Since this group of employees has already declined to opt out of automatic enrolment it would be reasonable to assume that either because they value savings or through inertia this group of employees would be less inclined to take a refund. Nevertheless in order to minimise the risk of underestimating the impact of this policy option we have used the initial automatic enrolment opt out assumption (ie that 20%-50% of eligible employees will opt out of automatic enrolment) to model whether or not employees will take a refund of contributions when given the option.<sup>17</sup>
29. The assumption applied in both scenarios is that when restrictions are imposed on short service refunds (either by allowing them only under an active member choice or by allowing them only until 2014/2017) that it is no longer in employers' interests to exploit short service refund rules, and it therefore no longer affects their scheme choice. In both cases this is a strong assumption, especially as larger employers (who are the only ones, according to pensions industry sources, whose choices will be affected by refund rules) are making scheme choices now. As such this should not be taken as a strong prediction of the state of the world expected to come about, but rather is the most-conservative assumption (ie the assumption with the lowest risk of underestimating employer burdens) that can be used about outcomes that are otherwise impossible to quantify.

## Option 1: Do nothing

### Description of option

30. Our first option is to do nothing and retain existing short service refund rules. This option would allow employers to continue to use schemes where the member is refunded their contributions when they leave within 2 years, and thereby retain their own contributions to off set costs. We expect that leaving the rules as they stand would lead to an increase in employers using Master Trusts, limiting some individuals' ability to build up pension savings and leading to their missing out on employer contributions.

### Costs and benefits (including administrative burden)

The following volumes estimates are generated using initial estimates of refund volumes described above. These are then updated using forecasts of numbers of employees leaving employment within 24 months of joining an employer. These forecasts come from the DWP's dynamic microsimulation model, which, because it is a stochastic model, predicts fluctuations in what would otherwise be 'steady state' volumes (hence the apparently random rise and fall in volumes and therefore costs/benefits in the latter years of the following tables).

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<sup>17</sup> This assumption was based on analysis of the 2009 Individuals Attitudes Survey, which asked individuals whether they would remain in a pension scheme into which they were automatically enrolled.

## Refund volumes: Option 1 – Do nothing

Year	Refund Volumes (thousands)	
	Low	High
2012/13	30	40
2013/14	30	60
2014/15	50	70
2015/16	50	70
2016/17	50	80
2017/18	50	80
2018/19	50	70
2019/20	50	70
2020/21	50	80
2030/31	50	70
2040/41	50	80
2050/51	50	80
<b>Average</b>	50	80

Note: The average figure given in the final row of this table includes years not covered by the table itself.

31. With the volumes estimates above and our initial estimates of the both the transfer and resource value of refunds, we are able to forecast transfer and resource implications until 2050.
32. Under option 1, we anticipate an average of 50,000-80,000 refunds per year, totalling £70m-£130m of individuals' pension savings, of which only £40m-£80m is returned to individuals. Employers receive £20m-£40m and the remainder reverts to the state as tax revenue on individuals' refunds. The net impact of these transfers is £0.

## Refund values / transfers: Option 1 – Do nothing

Year	Employers (£m)		State (£m)		Individuals (£m)		Pension Assets (£m)	
	Low	High	Low	High	Low	High	Low	High
2012/13	20	30	<5	10	10	20	-30	-60
2013/14	20	40	<5	10	10	30	-40	-80
2014/15	20	40	<5	10	20	30	-40	-80
2015/16	20	50	<5	10	20	40	-40	-90
2016/17	20	50	<5	10	20	40	-50	-100
2017/18	30	50	10	10	30	50	-60	-110
2018/19	30	50	10	10	30	60	-60	-110
2019/20	20	50	10	10	30	60	-70	-120
2020/21	20	40	10	10	40	60	-70	-120
2030/31	20	30	10	10	50	80	-70	-130
2040/41	20	40	10	20	50	90	-80	-150
2050/51	20	40	10	20	60	100	-90	-160
<b>Average</b>	20	40	10	10	40	80	-70	-130
<b>PV</b>	470	880	170	280	860	1,560	-1,490	-2,710

Note: All monetary figures for this and subsequent tables are in 2011/12 price terms; present value (PV) figures are in 2011/12 terms.

33. We also anticipate that administering the refunds themselves will impose a yearly cost below £5m on pension providers.

#### Resource costs: Option 1 – Do nothing

Year	Industry costs (incl transition)	
	Low	High
2012/13	<2.5	<2.5
2013/14	<2.5	-5
2014/15	<2.5	-5
2015/16	<2.5	-5
2016/17	<2.5	-5
2017/18	<2.5	-5
2018/19	<2.5	-5
2019/20	<2.5	-5
2020/21	<2.5	-5
2030/31	<2.5	-5
2040/41	-5	-5
2050/51	<2.5	-5
<b>Average</b>	<2.5	-5
<b>PV</b>	-50	-80

34. These costs constitute the baseline against which the other policy options are assessed.

## Option 2: Make refunds an active choice from 2014

### Description of option

35. Our second option is to change the legislation in relation to trust based defined contribution schemes to prevent the refund of the contributions being the default action when a member does not make an active choice. This would mean that from 2014 the individual would still have the option to take a refund or cash transfer value when they leave the occupational DC scheme with short service, but if they make no choice the pot would remain in the scheme. This makes taking the refund an active choice.
36. This option involves a change to primary legislation to remove the ability to give the refund automatically where the member does not make a choice between a refund and a transfer. Specifically it involves modifying section 101 of the Pension Schemes Act 1993 to mandate that where a member does not make a choice they become entitled to a future pension in the scheme.
37. This option would impact all employers who run DC occupational schemes which operate a short service refund period. It would also affect those pension providers who offer Master Trust pension products.

## Costs and benefits (including administrative burden);

### Refund volumes: Option 2 – Make refunds an active choice from 2014

Year	Refund Volumes (thousands)	
	Low	High
2012/13	20	30
2013/14	20	40
2014/15	<5	20
2015/16	<5	20
2016/17	<5	20
2017/18	<5	20
2018/19	<5	20
2019/20	<5	20
2020/21	<5	20
2030/31	<5	20
2040/41	<5	20
2050/51	<5	20
<b>Average</b>		
	<5	20

### Refund values / transfers: Option 2 – Make refunds an active choice from 2014

Year	Employers (£m)		State (£m)		Individuals (£m)		Pension Assets (£m)	
	Low	High	Low	High	Low	High	Low	High
2012/13	20	30	<5	10	10	20	-30	-60
2013/14	20	40	<5	10	10	30	-30	-80
2014/15	<5	20	<5	<5	<5	20	-10	-40
2015/16	<5	20	<5	<5	<5	20	-10	-40
2016/17	<5	20	<5	<5	<5	20	-10	-40
2017/18	<5	20	<5	<5	<5	20	-10	-40
2018/19	<5	20	<5	<5	<5	20	-10	-40
2019/20	<5	20	<5	<5	<5	20	-10	-40
2020/21	<5	20	<5	<5	<5	20	-10	-40
2030/31	<5	10	<5	<5	10	30	-10	-50
2040/41	<5	10	<5	<5	10	30	-10	-50
2050/51	<5	20	<5	<5	10	40	-10	-60
<b>Average</b>								
	<5	20	<5	<5	10	30	-10	-50
<b>PV</b>	90	390	20	100	120	610	-240	-1,100

38. Under this option, we anticipate up to 20,000 refunds per year, totalling £10m-£50m of individuals' pension savings, of which individuals receive only £10m-£30m. Employers receive up to £20m and the remainder reverts to the state as tax revenue on individuals' refunds. The net impact of these transfers is £0.

39. This is 40,000-50,000 fewer refunds per year than under option 1 (do nothing) and so would increase pension savings by £60m-£80m, at a cost of £20m to employers, £40m-£50m to employees and £10m to the state

**Refund volumes relative to Option 1: Option 2 – Make refunds an active choice from 2014**

Year	Refund Volumes (thousands)	
	Low	High
2012/13	-10	-10
2013/14	-20	-20
2014/15	-40	-50
2015/16	-40	-50
2016/17	-50	-60
2017/18	-50	-60
2018/19	-40	-50
2019/20	-40	-50
2020/21	-50	-60
2030/31	-50	-50
2040/41	-50	-60
2050/51	-50	-60
<b>Average</b>	-40	-50

**Refund values / transfers relative to Option 1: Option 2 – Make refunds an active choice from 2014**

Year	Employers (£m)		State (£m)		Individuals (£m)		Pension Assets (£m)	
	Low	High	Low	High	Low	High	Low	High
2012/13	<-5	<-5	<-5	<-5	<-5	<-5	<5	<5
2013/14	<-5	<-5	<-5	<-5	<-5	<-5	<5	<5
2014/15	-20	-20	<-5	<-5	-10	-20	30	50
2015/16	-20	-20	<-5	<-5	-20	-20	40	50
2016/17	-20	-30	<-5	-10	-20	-20	40	60
2017/18	-20	-30	-10	-10	-20	-30	50	70
2018/19	-20	-30	-10	-10	-30	-40	60	70
2019/20	-20	-30	-10	-10	-30	-40	60	70
2020/21	-20	-30	-10	-10	-30	-40	60	80
2030/31	-20	-20	-10	-10	-40	-50	60	80
2040/41	-20	-20	-10	-10	-50	-60	70	90
2050/51	-20	-30	-10	-10	-50	-60	80	100
<b>Average</b>	-20	-20	-10	-10	-40	-50	60	80
<b>PV</b>	-370	-480	-140	-180	-740	-940	1,250	1,610



**Resource costs: Option 2 – Make refunds an active choice from 2014**

	Industry costs (incl transition)	
Year	Low	High
2012/13	-5	-5
2013/14	-5	-5
2014/15	-10	-10
2015/16	-10	-10
2016/17	-10	-10
2017/18	-5	-10
2018/19	-5	-10
2019/20	-5	-10
2020/21	-5	-10
2030/31	-5	-10
2040/41	-5	-10
2050/51	-5	-5
<b>Average</b>	-5	-10
<b>PV</b>	-135	-180

40. We anticipate that retaining more pension pots increases the pensions industry's costs by £5m per year, to £5m-£10m.

**Resource costs relative to Option 1: Option 2 – Make refunds an active choice from 2014**

	Industry costs (incl transition)	
Year	Low	High
2012/13	<-5	<-5
2013/14	-5	-5
2014/15	-5	-10
2015/16	-5	-5
2016/17	-5	-5
2017/18	-5	-5
2018/19	-5	-5
2019/20	-5	-5
2020/21	-5	-5
2030/31	-5	-5
2040/41	-5	-5
2050/51	-5	-5
<b>Average</b>	-5	-5
<b>PV</b>	-85	-100

## Risks and assumptions;

41. If the cost of administering an individual's pension pot is £15 rather than £25 per year, the cost of Option 2 to pension providers falls to below £5m per year, an improvement of below £2.5m compared to Option 1.

## Direct costs and benefits to business calculations (following OIOO methodology);

42. The Equivalent Annual Net Cost to Business of Option 2 is £20m evaluated over 39 years. This is a regulatory IN.
43. Prior impact assessments of automatic enrolment presumed no significant expansion of short service refunds beyond their current level. This means that, while this policy does still have an EANCB of £20m, £10m of this has already been incorporated in the IN associated with ERSP, so for the sake of one-in-one-out accounting, only £10m should be added to the DWP's total. The policy analysed in this impact assessment effectively only removes something that was previously assumed to be unavailable as a means for employers to minimise their exposure to contribution costs.<sup>18</sup>

## Equality impact

44. Since the policy options analysed in this impact assessment differ only in magnitude (they all effectively increase large employers' contributions to short term employees' pensions) we have addressed equality impacts in a single section, beginning at paragraph 73]

## Option 3: Make refunds an active choice from 2017

### Description of option

45. Our second option is to change the legislation in relation to trust based defined contribution schemes to prevent the refund of the contributions being the default action when a member does not make an active choice. This would mean that from 2017 the individual would still have the option to take a refund or cash transfer value when they leave the occupational DC scheme with short service, but if they make no choice the pot would remain in the scheme. This makes taking the refund an active choice.
46. This option involves a change to primary legislation to remove the ability to give the refund automatically where the member does not make a choice between a refund and a transfer. Specifically it involves modifying section 101 of the Pension Schemes Act 1993 to mandate that where a member does not make a choice they become entitled to a future pension in the scheme.
47. This option would impact all employers who run DC occupational schemes which operate a short service refund period. It would also affect those pension providers who offer Master Trust pension products.

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<sup>18</sup> For further information, see:

Pensions Bill Impact Assessment – April 2008

Impact Assessment: (Automatic Enrolment) Regulations – March 2009

Impact Assessment: consultation stage – Workplace Pension Reform (Completing the Picture) Regulations 2009

Workplace Pension Reform Regulations: Impact Assessment – January 2010

Pensions Bill Impact Assessment – January 2011

## Costs and benefits (including administrative burden);

### Refund volumes: Option 3 – Make refunds an active choice from 2017

Year	Refund Volumes (thousands)	
	Low	High
2012/13	20	30
2013/14	20	40
2014/15	20	40
2015/16	20	40
2016/17	20	40
2017/18	<5	20
2018/19	<5	20
2019/20	<5	20
2020/21	<5	20
2030/31	<5	20
2040/41	<5	20
2050/51	<5	20
<b>Average</b>	10	20

### Refund values / transfers: Option 3 – Make refunds an active choice from 2017

Year	Employers (£m)		State (£m)		Individuals (£m)		Pension Assets (£m)	
	Low	High	Low	High	Low	High	Low	High
2012/13	20	30	<5	10	10	20	-30	-60
2013/14	20	40	<5	10	10	30	-30	-80
2014/15	20	40	<5	10	10	30	-30	-80
2015/16	20	40	<5	10	20	30	-40	-80
2016/17	20	40	<5	10	20	40	-40	-90
2017/18	<5	20	<5	<5	<5	20	-10	-40
2018/19	<5	20	<5	<5	<5	20	-10	-40
2019/20	<5	20	<5	<5	<5	20	-10	-40
2020/21	<5	20	<5	<5	<5	20	-10	-40
2030/31	<5	10	<5	<5	10	30	-10	-50
2040/41	<5	10	<5	<5	10	30	-10	-50
2050/51	<5	20	<5	<5	10	40	-10	-60
<b>Average</b>	<5	20	<5	<5	10	30	-10	-50
<b>PV</b>	130	450	30	110	160	660	-320	-1,210

48. Under this option, we anticipate an average of 10,000-20,000 refunds per year, totalling £10m-£50m of individuals' pension savings, of which individuals receive only £10m-£30m. Employers receive up to £20m and the remainder reverts to the state as tax revenue on individuals' refunds. The net impact of these transfers is £0.

49. This is 40,000-50,000 fewer refunds per year than under option 1 (do nothing) and so would increase pension savings by £60m-£80m, at a cost of £20m to employers, £40m-£50m to employees and £10m to the state

#### Refund volumes relative to Option 1: Option 3 – Make refunds an active choice from 2017

Year	Refund Volumes (thousands)	
	Low	High
2012/13	-10	-10
2013/14	-20	-20
2014/15	-30	-30
2015/16	-30	-30
2016/17	-30	-30
2017/18	-50	-60
2018/19	-40	-50
2019/20	-40	-50
2020/21	-50	-60
2030/31	-50	-50
2040/41	-50	-60
2050/51	-50	-60
<b>Average</b>	-40	-50

#### Refund values / transfers relative to Option 1: Option 3 – Make refunds an active choice from 2017

Year	Employers (£m)		State (£m)		Individuals (£m)		Pension Assets (£m)	
	Low	High	Low	High	Low	High	Low	High
2012/13	<-5	<-5	<-5	<-5	<-5	<-5	<5	<5
2013/14	<-5	<-5	<-5	<-5	<-5	<-5	<5	<5
2014/15	<-5	<-5	<-5	<-5	<-5	<-5	10	10
2015/16	<-5	<-5	<-5	<-5	<-5	<-5	10	10
2016/17	-10	-10	<-5	<-5	-10	-10	10	10
2017/18	-20	-30	-10	-10	-20	-30	50	70
2018/19	-20	-30	-10	-10	-30	-40	60	70
2019/20	-20	-30	-10	-10	-30	-40	60	70
2020/21	-20	-30	-10	-10	-30	-40	60	80
2030/31	-20	-20	-10	-10	-40	-50	60	80
2040/41	-20	-20	-10	-10	-50	-60	70	90
2050/51	-20	-30	-10	-10	-50	-60	80	100
<b>Average</b>	-20	-20	-10	-10	-40	-50	60	80
<b>PV</b>	-330	-430	-140	-170	-700	-900	1,170	1,500

**Resource costs: Option 3 – Make refunds an active choice from 2017**

Year	Industry costs (incl transition)	
	Low	High
2012/13	-5	-5
2013/14	-5	-5
2014/15	-5	-10
2015/16	-5	-10
2016/17	-5	-10
2017/18	-5	-10
2018/19	-5	-10
2019/20	-5	-10
2020/21	-5	-10
2030/31	-5	-10
2040/41	-5	-10
2050/51	-5	-5
<b>Average</b>	-5	-10
<b>PV</b>	-135	-175

50. We anticipate that the impact on the pensions industry of retaining more pension pots increases the pension industry's annual costs by around £5m compared to option 1. This would bring costs up to £5m-£10m.

**Resource costs relative to Option 1: Option 3 – Make refunds an active choice from 2017**

Year	Industry costs (incl transition)	
	Low	High
2012/13	<-5	<-5
2013/14	-5	-5
2014/15	-5	-5
2015/16	-5	-5
2016/17	-5	-5
2017/18	-5	-5
2018/19	-5	-5
2019/20	-5	-5
2020/21	-5	-5
2030/31	-5	-5
2040/41	-5	-5
2050/51	-5	-5
<b>Average</b>	-5	-5
<b>PV</b>	-80	-95

## Risks and assumptions;

51. If the cost of administering an individual's pension pot is £15 rather than £25 per year, the cost of option 3 to pension providers falls to below £5m per year, though is still slightly higher than the cost of option 1.

## Direct costs and benefits to business calculations (following OIOO methodology);

52. The Equivalent Annual Net Cost to Business of Option 2 is £20m evaluated over 39 years. This is a regulatory IN.
53. Prior impact assessments of automatic enrolment presumed no significant expansion of short service refunds beyond their current level. This means that, while this policy does still have an EANCB of £20m, £10m of this has already been incorporated in the IN associated with ERSP, so for the sake of one-in-one-out accounting, only £10m should be added to the DWP's total. The policy analysed in this impact assessment effectively only removes something that was previously assumed to be unavailable as a means for employers to minimise their exposure to contribution costs.

## Equality impact

54. Since the policy options analysed in this impact assessment differ only in magnitude (they all effectively increase large employers' contributions to short term employees' pensions) we have addressed equality impacts in a single section, beginning at paragraph 73]

## **Option 4: Abolish short service refunds from 2014**

### Description of option

55. Government can abolish short service refunds from 2014 for all DC occupational schemes. Under this option the government could change legislation to stop the contribution refund. The member would then have the continued right to a transfer of the full value or to leave their pension pot in the scheme. If the member makes no choice their pension pot would remain in the scheme
56. As with the option to make the refund an active choice this would involve a change to primary legislation to remove the right to a refund where the pension rights have not vested in the occupational scheme. This involves modifying section 101 of the Pension Schemes Act 1993 to make immediate vesting in the scheme compulsory.
57. Similar to the second option, abolishing short service refunds would impact all employers who run DC occupational schemes which operate a short service refund period. It would also affect those pension providers who offer Master Trust pension products.

## Costs and benefits (including administrative burden);

### Refund volumes: Option 4 – abolish short service refunds from 2014

Year	Refund Volumes (thousands)	
	Low	High
2012/13	20	30
2013/14	20	40
2014/15	0	0
2015/16	0	0
2016/17	0	0
2017/18	0	0
2018/19	0	0
2019/20	0	0
2020/21	0	0
2030/31	0	0
2040/41	0	0
2050/51	0	0
<b>Average</b>		
	<5	<5

### Refund values / transfers: Option 4 – Abolish short service refunds from 2014

Year	Employers (£m)		State (£m)		Individuals (£m)		Pension Assets (£m)	
	Low	High	Low	High	Low	High	Low	High
2012/13	20	30	<5	10	10	20	-30	-60
2013/14	20	40	<5	10	10	30	-30	-80
2014/15	0	0	0	0	0	0	0	0
2015/16	0	0	0	0	0	0	0	0
2016/17	0	0	0	0	0	0	0	0
2017/18	0	0	0	0	0	0	0	0
2018/19	0	0	0	0	0	0	0	0
2019/20	0	0	0	0	0	0	0	0
2020/21	0	0	0	0	0	0	0	0
2030/31	0	0	0	0	0	0	0	0
2040/41	0	0	0	0	0	0	0	0
2050/51	0	0	0	0	0	0	0	0
<b>Average</b>								
	<5	<5	<5	<5	<5	<5	<-5	<-5
<b>PV</b>	40	70	10	10	20	50	-70	-130

58. Under this option, we anticipate an average of 20,000-40,000 refunds per year until 2014, 0 thereafter, totalling below £5m of individuals' pension savings per year averaged over the whole of the period 2012 to 2050. The net impact of these transfers is £0.

59. This is 50,000-70,000 fewer refunds per year than under option 1 (do nothing) and so would increase pension savings by £70m-£130m, at a cost of £20m-£40m to employers, £40m-£80m to employees and £10m to the state

#### Refund volumes relative to Option 1: Option 4 – abolish short service refunds from 2014

Year	Refund Volumes (thousands)	
	Low	High
2012/13	-10	-10
2013/14	-20	-20
2014/15	-50	-70
2015/16	-50	-70
2016/17	-50	-80
2017/18	-50	-80
2018/19	-50	-70
2019/20	-50	-70
2020/21	-50	-80
2030/31	-50	-70
2040/41	-50	-80
2050/51	-50	-80
<b>Average</b>	-50	-70

#### Refund values / transfers relative to Option 1: Option 4 – Abolish short service refunds from 2014

Year	Employers (£m)		State (£m)		Individuals (£m)		Pension Assets (£m)	
	Low	High	Low	High	Low	High	Low	High
2012/13	<-5	<-5	<-5	<-5	<-5	<-5	<5	<5
2013/14	<-5	<-5	<-5	<-5	<-5	<-5	<5	<5
2014/15	-20	-40	<-5	-10	-20	-30	40	80
2015/16	-20	-50	<-5	-10	-20	-40	40	90
2016/17	-20	-50	<-5	-10	-20	-40	50	100
2017/18	-30	-50	-10	-10	-30	-50	60	110
2018/19	-30	-50	-10	-10	-30	-60	60	110
2019/20	-20	-50	-10	-10	-30	-60	70	120
2020/21	-20	-40	-10	-10	-40	-60	70	120
2030/31	-20	-30	-10	-10	-50	-80	70	130
2040/41	-20	-40	-10	-20	-50	-90	80	150
2050/51	-20	-40	-10	-20	-60	-100	90	160
<b>Average</b>	-20	-40	-10	-10	-40	-80	70	130
<b>PV</b>	-430	-800	-160	-260	-840	-1,510	1,420	2,570



### Resource costs: Option 4 – Abolish short service refunds from 2014

Year	Provider costs (incl transition)	
	Low	High
2012/13	-5	-5
2013/14	-5	-5
2014/15	-10	-10
2015/16	-10	-10
2016/17	-10	-10
2017/18	-5	-10
2018/19	-5	-10
2019/20	-5	-10
2020/21	-5	-10
2030/31	-5	-10
2040/41	-5	-10
2050/51	-5	-5
<b>Average</b>	-5	-10
<b>PV</b>	-140	-195

60. We anticipate that this option would impose a yearly cost on pension providers of £5m-£10m. Relative to option 1, this is increases providers costs by around £5m per year.

### Resource costs relative to Option 1: Option 4 – Abolish short service refunds from 2014

Year	Provider costs (incl transition)	
	Low	High
2012/13	<-5	<-5
2013/14	-5	-5
2014/15	-5	-10
2015/16	-5	-5
2016/17	-5	-5
2017/18	-5	-5
2018/19	-5	-5
2019/20	-5	-5
2020/21	-5	-5
2030/31	-5	-5
2040/41	-5	-5
2050/51	-5	-5
<b>Average</b>	-5	-5
<b>PV</b>	-85	-115

## Risks and assumptions;

61. If the cost of administering an individual's pension pot is £15 per year instead of £25, the cost to pension providers falls below £5m and option 4 becomes marginally cheaper to providers than option 1.

## Direct costs and benefits to business calculations (following OIOO methodology);

62. Option 4 represents a regulatory IN with an EANCB of £20m-£40m, of which £10m is 'new' cost, the remainder having already been incorporated under ERSP<sup>19</sup>.

## Equality impact

63. Since the policy options analysed in this impact assessment differ only in magnitude (they all effectively increase large employers' contributions to short term employees' pensions) we have addressed equality impacts in a single section, beginning at paragraph 73]

## **Option 5: Abolish short service refunds from 2017**

### Description of option

64. Government can abolish short service refunds from 2017 for all DC occupational schemes. Under this option the government could change legislation to stop the contribution refund. The member would then have the continued right to a transfer of the full value or to leave their pension pot in the scheme. If the member makes no choice their pension pot would remain in the scheme.
65. As with the option to make the refund an active choice this would involve a change to primary legislation to remove the right to a refund where the pension rights have not vested in the occupational scheme. This involves modifying section 101 of the Pension Schemes Act 1993 to make immediate vesting in the scheme compulsory.
66. Similar to the second option, abolishing short service refunds would impact all employers who run DC occupational schemes which operate a short service refund period. It would also affect those pension providers who offer Master Trust pension products.

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<sup>19</sup> See discussion under EANCB implications of Option 2

## Costs and benefits (including administrative burden);

### Refund volumes: Option 5 – abolish short service refunds from 2017

Year	Refund Volumes (thousands)	
	Low	High
2012/13	20	30
2013/14	20	40
2014/15	20	40
2015/16	20	40
2016/17	20	40
2017/18	0	0
2018/19	0	0
2019/20	0	0
2020/21	0	0
2030/31	0	0
2040/41	0	0
2050/51	0	0
<b>Average</b>		
	<5	<5

### Refund values / transfers: Option 5 – Abolish short service refunds from 2017

Year	Employers (£m)		State (£m)		Individuals (£m)		Pension Assets (£m)	
	Low	High	Low	High	Low	High	Low	High
2012/13	20	30	<5	10	10	20	-30	-60
2013/14	20	40	<5	10	10	30	-30	-80
2014/15	20	40	<5	10	10	30	-30	-80
2015/16	20	40	<5	10	20	30	-40	-80
2016/17	20	40	<5	10	20	40	-40	-90
2017/18	0	0	0	0	0	0	0	0
2018/19	0	0	0	0	0	0	0	0
2019/20	0	0	0	0	0	0	0	0
2020/21	0	0	0	0	0	0	0	0
2030/31	0	0	0	0	0	0	0	0
2040/41	0	0	0	0	0	0	0	0
2050/51	0	0	0	0	0	0	0	0
<b>Average</b>								
	<5	10	<5	<5	<5	<5	<-5	-10
<b>PV</b>	90	190	10	30	60	140	-170	-360

67. Under this option, we anticipate an average of 20,000-40,000 refunds per year until 2017, 0 thereafter, totalling below £10m of individuals' pension savings per year averaged over the whole of the period 2012 to 2050. Of this below £5m is returned to individuals, below £10m to employers and the remainder to the state. The net impact of these transfers is £0.

68. This is 50,000-70,000 fewer refunds per year than under option 1 (do nothing) and so would increase pension savings by £70m-£120m, at a cost of £20m-£30m to employers, £40m-£80m to employees and £10m to the state

**Refund volumes relative to Option 1: Option 5 – abolish short service refunds from 2017**

Year	Refund Volumes (thousands)	
	Low	High
2012/13	-10	-10
2013/14	-20	-20
2014/15	-30	-30
2015/16	-30	-30
2016/17	-30	-30
2017/18	-50	-80
2018/19	-50	-70
2019/20	-50	-70
2020/21	-50	-80
2030/31	-50	-70
2040/41	-50	-80
2050/51	-50	-80
<b>Average</b>	-50	-70

**Refund values / transfers relative to Option 1: Option 5 – Abolish short service refunds from 2017**

Year	Employers (£m)		State (£m)		Individuals (£m)		Pension Assets (£m)	
	Low	High	Low	High	Low	High	Low	High
2012/13	<-5	<-5	<-5	<-5	<-5	<-5	<5	<5
2013/14	<-5	<-5	<-5	<-5	<-5	<-5	<5	<5
2014/15	<-5	<-5	<-5	<-5	<-5	<-5	10	10
2015/16	<-5	<-5	<-5	<-5	<-5	<-5	10	10
2016/17	-10	-10	<-5	<-5	-10	-10	10	10
2017/18	-30	-50	-10	-10	-30	-50	60	110
2018/19	-30	-50	-10	-10	-30	-60	60	110
2019/20	-20	-50	-10	-10	-30	-60	70	120
2020/21	-20	-40	-10	-10	-40	-60	70	120
2030/31	-20	-30	-10	-10	-50	-80	70	130
2040/41	-20	-40	-10	-20	-50	-90	80	150
2050/51	-20	-40	-10	-20	-60	-100	90	160
<b>Average</b>	-20	-30	-10	-10	-40	-80	70	120
<b>PV</b>	-380	-690	-150	-240	-800	-1,420	1,320	2,350

## Resource costs: Option 5 – Abolish short service refunds from 2017

Year	Provider costs (incl transition)	
	Low	High
2012/13	-5	-5
2013/14	-5	-5
2014/15	-5	-10
2015/16	-5	-10
2016/17	-5	-10
2017/18	-5	-10
2018/19	-5	-10
2019/20	-5	-10
2020/21	-5	-10
2030/31	-5	-10
2040/41	-5	-10
2050/51	-5	-5
<b>Average</b>	-5	-10
<b>PV</b>	-135	-190

69. We anticipate that the cost of option 5 to pension providers will be £5m-£10m. Relative to option 1, this is a reduction in costs by around £5m.

## Resource costs relative to Option 1: Option 5 – Abolish short service refunds from 2017

Year	Provider costs (incl transition)	
	Low	High
2012/13	<-5	-5
2013/14	-5	-5
2014/15	-5	-5
2015/16	-5	-5
2016/17	-5	-5
2017/18	-5	-5
2018/19	-5	-5
2019/20	-5	-5
2020/21	-5	-5
2030/31	-5	-5
2040/41	-5	-5
2050/51	-5	-5
<b>Average</b>	-5	-5
<b>PV</b>	-85	-110

## Risks and assumptions;

70. If the cost of administering an individual's pension pot is £15 per year instead of £25, the £5m-£10m cost to pension providers becomes a cost below £5m, marginally less than option 1.

## Direct costs and benefits to business calculations (following OIOO methodology);

71. Option 5 represents a regulatory IN with an EANCB of £20m-£30m, of which £10m is 'new' cost, the remainder having already been incorporated under ERSP<sup>20</sup>.

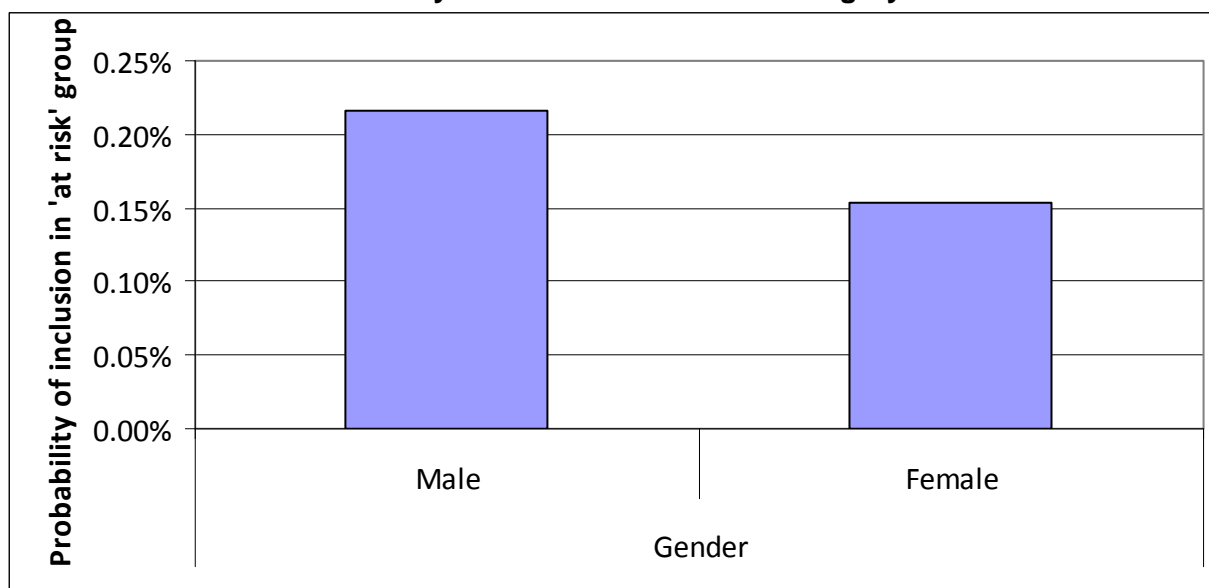
## Equality impact

72. Since the policy options analysed in this impact assessment differ only in magnitude (they all effectively increase large employers' contributions to short term employees' pensions) we have addressed equality impacts in a single section, beginning at paragraph 73]

## Overall Equality Impact

73. We have already stated in paragraph 10 that individuals who leave work with short service are twice as likely as the rest of the population to be aged below 30 and be moderate to low earners. For this analysis we define individuals leaving a large employer within 24 months of joining them as being 'at risk' of receiving a short service refund. As described above, informal engagement with pensions intermediaries have suggested that in the overwhelming majority of cases, only employers of 1,000 or more employees will see sufficient benefits from operating short service refunds for it to influence scheme choice.
74. Each of the policy options considered above proposes a restriction on short service refunds, which in turn is expected to increase pension savings of the 'at risk' group, including an employer subsidy. In figures 2, 3 and 4 we can see, respectively, the impact of gender, ethnicity and disability status on the probability of inclusion in the 'at risk' category. These figures show that males, individuals of minority ethnicity and individuals with no disability (defined either with respect to work or the Disability Discrimination Act) are more likely than their counterparts to be included in the 'at risk' category, but further analysis concludes that in each case this effect is not statistically significant.<sup>21</sup>
75. Figure 5 shows that younger people are more likely to be included in the 'at risk' category. In particular, 16-24 year olds are three times as likely as 25-34 year olds to be included in the 'at risk' category; each of the remaining groups is around twice as likely as the next age group up to be included in the 'at risk' category. This effect is statistically significant in all cases. However the absolute impact on the probability of inclusion in the 'at risk' category is around 40 basis points (0.4 percentage points) and so given the small positive impact on younger employees and the limit of the impact on older employees, we consider this to be acceptable.

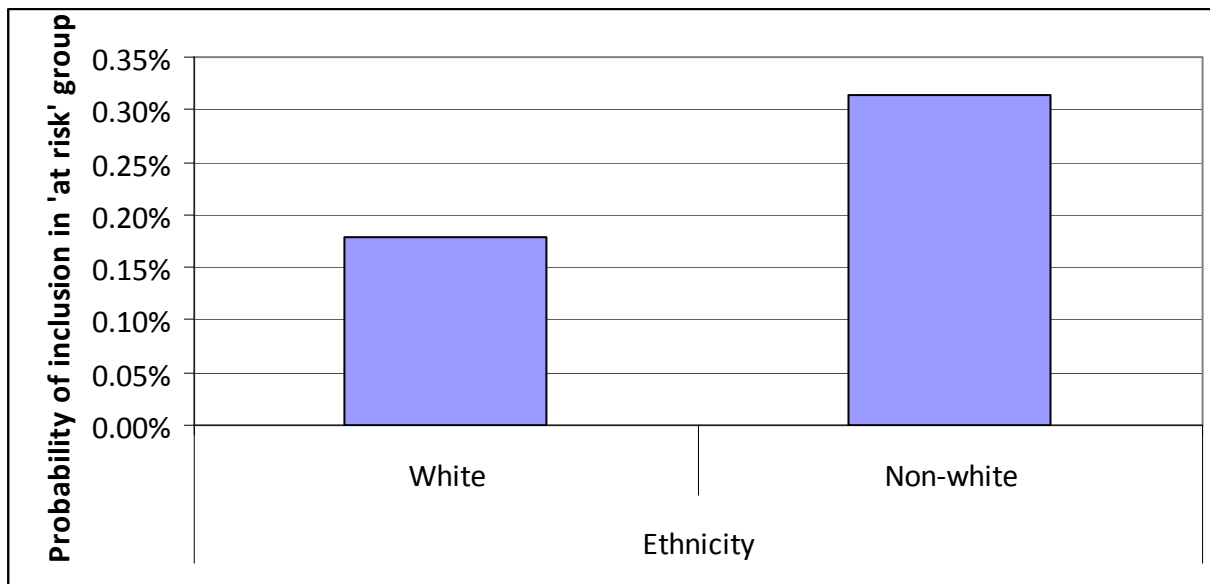
**Figure 2: Gender and the Probability of Inclusion in 'at risk' Category**



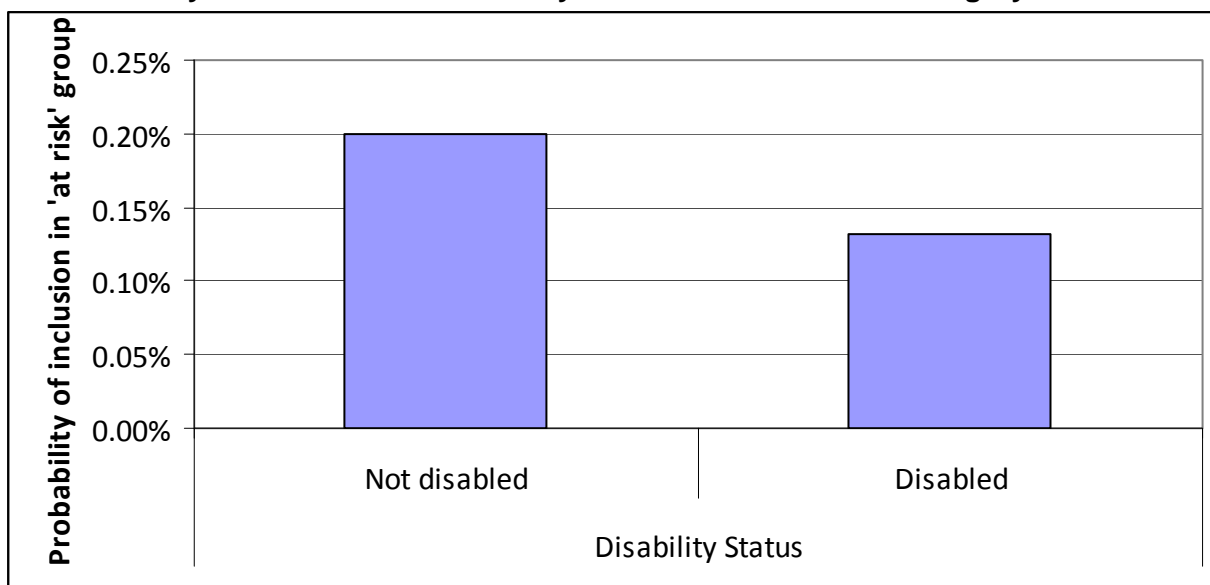
<sup>20</sup> See discussion under EANCB implications of Option 2

<sup>21</sup> Tests conducted at the 5% level

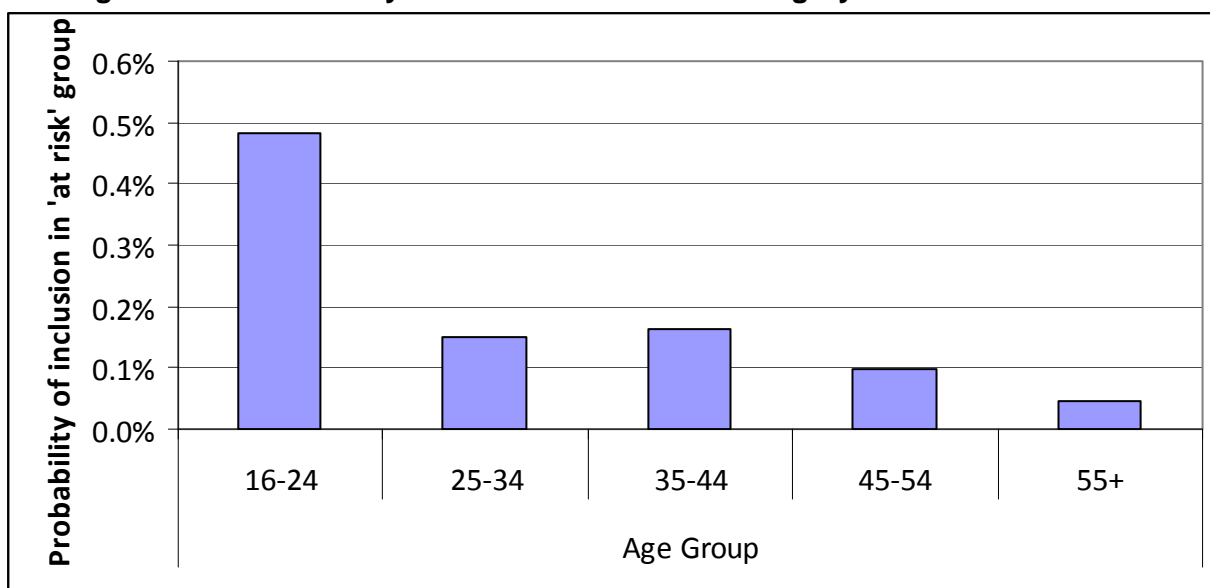
**Figure 3: Ethnicity and the Probability of Inclusion in 'at risk' Category**



**Figure 4: Disability Status and the Probability of Inclusion in 'at risk' Category**



**Figure 5: Age and the Probability of Inclusion in 'at risk' Category**



## Summary and preferred option

The preferred option is abolition of short service refunds in 2014. Only a ban can fully prevent market distortions from impeding short service employees' access to savings opportunities enjoyed by the rest of the eligible population.