

Title: Limited backdated claims for unauthorised deduction of wages IA No: BISLM007 Lead department or agency: Department for Business, Innovations and Skills Other departments or agencies:	Impact Assessment (IA)				
	Date: 18/12/2014				
	Stage: Final Stage				
	Source of intervention: Domestic				
	Type of measure: Secondary legislation				
Contact for enquiries: Mansi Konar (mansi.konar@bis.gsi.gov.uk) Amy Newland (Amy.newland@bis.gsi.gov.uk)					

Summary: Intervention and Options	RPC Opinion: TBC
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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, Two-Out?	Measure qualifies as
-£10m	£296m (savings)	TBC	IN	OUT

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

The Employment Rights Act does not currently set a limit on the period for backdated claims from employees for unlawful deductions from wages by employers. The potential period to allow backdated claims is therefore uncertain and would depend on Employment Tribunal rulings leading to a range of possible outcomes depending on the nature of the case. This uncertainty is detrimental to businesses, making it difficult to estimate, plan for and manage the potential costs they face. Similarly, it creates uncertainty for the individual. This problem has been exacerbated by the recent Employment Appeal Tribunal judgment (*Fulton v Bear Scotland* (2014 UKEATS/0047/13) on the Working Time Directive, which is opening the potential for significant claims to UK businesses who were at the time complying in good faith with the law prior to the tribunal judgment.

What are the policy objectives and the intended effects?

The Government 's objectives are:

- 1) To limit the burden on businesses and reduce the scope (and impact) of backdating of liability provisions that currently exist and
- 2) To provide certainty to employers and workers. Various options are considered that amend the Employment Rights Act 1996 to reduce the scope of liability by limiting how far claims can go back.

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

The options considered were as follows:

- Do nothing – This option does not limit uncertainty about the time period to which businesses will be liable for claims nor reduce liabilities of businesses following the recent Tribunal ruling on holiday pay.
- Option 1 - Introduce a backstop period (i.e. period for which claims can be backdated) of 6 years. This option was not considered to be the preferred option as whilst it provides certainty it still leaves businesses with significant potential liabilities following the recent Tribunal ruling.
- Option 2 - Introduce a backstop period of shorter than 6 years with a transition period (i.e. when claims can be made before the backstop is imposed). The option of a 2 year backstop together with a 6 month transition period is the preferred option. This is based on the best combination of certainty for all parties and restoring a more appropriate balance on the liabilities businesses could face.

Will the policy be reviewed? It will be reviewed. If applicable, set review date: 2018

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.	Micro Yes	< 20 Yes	Small Yes	Medium Yes	Large Yes
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)			Traded:		Non-traded:

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 SELECT SIGNATORY: Jo Swinson Date: 16th December
2014

Summary: Analysis & Evidence

Policy Option 1

Description: Introduce a backstop period (i.e. period for which claims can be backdated) of 6 years

FULL ECONOMIC ASSESSMENT

Price Base Year 2014	PV Base Year 2014	Time Period Years 3	Net Benefit (Present Value (PV)) (£m)		
			Low: -£10m	High: -£10m	Best Estimate: -£10m

COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	£10m	1	£45m	£140m
High	£10m		£155m	£460m
Best Estimate	£10m		£100m	£300m

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

- Employees working for longer than six years will lose out on overtime payments they would have otherwise been entitled to if claims went back to 1998 (as under the counterfactual). We estimate these gross payments (including tax) to be £130m to £450m (best estimate £290m) and they also include loss to the exchequer in terms of taxes forgone.
- There will be additional one-off familiarisation costs to employers from understanding whether the government measure (to limit backdated claims) would affect them and we estimate these to be £10m. These costs arise once they have already considered implication of the EAT judgment (the latter costs are substantial and are not considered to be additional for the purposes of this IA).

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	1	£45m	£130m
High	0		£155m	£450m
Best Estimate	0		£100m	£290m

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

There will be cost savings to businesses from not having to pay overtime to employees for more than six years going back. These are estimated to be £130m to £450m (with a best estimate of £290m) and include both wage and non-wage payments. The savings to the private sector are estimated to be £230m and to the public sector to be £60m.

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

Limiting how far claims can go back reduces the time spent by businesses on estimating liabilities per employee. Cost savings are likely to be higher for firms that do not have the necessary systems to allow them to easily access information on historical overtime payments.

Key assumptions/sensitivities/risks

Discount rate (%)

3.5

The main assumptions of the analysis are as follows:

- Some employees working overtime might not be eligible to make a claim (for example, they might be working overtime on an adhoc basis) or they might already have overtime reflected in their holiday pay. We assume that 55-75% of employees who work overtime are doing so on a regular basis. Of these employees, we assume 27% get all of their paid overtime included in their holiday pay, and 8% only get part of the overtime included in their overtime in their holiday pay. These estimates are based on a business survey.
- Not all employees eligible for a claim will make a claim. We assume that between 10% and 35% (best estimate 22.5%) of eligible employees are likely to make a claim under option 1. The cost savings to business (against the counterfactual) are sensitive to these take up rate estimates (higher the take-up rate higher is the savings).
- We do not have data on hours of overtime worked by employees and use the length of service of those working overtime in 2014 as a proxy of the past patterns of overtime worked. This assumes that the workers display the same pattern of hours throughout their years of service and that their overtime has continuously not been reflected in their holiday pay.
- We look at an appraisal period of 3 years as this impact assessment only concerns backdated claims (that were accrued from overtime worked in the past). Not all claims will be made in the first year (i.e. year 0). We allow claims to spill over to year 1 and 2 and thereafter we assume firms will be compliant with the law (and stopping claims coming forward).

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: TBC	Benefits: TBC	Net: TBC	IN	OUT

Summary: Analysis & Evidence

Policy Option 2 (preferred option)

Description: The option of a 2 year backstop together with a 6 month transition period

FULL ECONOMIC ASSESSMENT

Price Base Year 2014	PV Base Year 2014	Time Period Years 3	Net Benefit (Present Value (PV)) (£m)		
			Low: -£10m	High:- £10m	Best Estimate: -£10m

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)	
Low	£10m	1	£30m	£90
High	£10m	1	£240m	£690
Best Estimate	£10m	1	£130m	£390m

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

- Employees working for longer than two years will lose out on overtime payments they would have otherwise been entitled to if claims went back to 1998 (as under the counterfactual). We estimate these gross payments to be £380m and they also include loss to the exchequer in terms of taxes forgone.
- There will be additional one-off familiarisation costs to employers from understanding whether the government measure (to limit backdated claims) would affect them and we estimate these to be £10m. These costs arise once they have already considered implication of the EAT judgment (the latter costs are substantial and not considered to be additional for the purpose of the IA).

The average annual costs are expressed as fixed costs in the table above. However, these vary across the years due to the impact of the transition period. See para 24 in the evidence base for an explanation on the distribution of flow of claims over the appraisal period.

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	1	£30m	£80m
High	0	1	£240m	£680m
Best Estimate	0	1	£130m	£380m

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

There will be cost savings to businesses from not having to pay overtime to employees for more than two years going back. This is estimated to be £80m - £680m (best estimate £380m) and include both wage and non-wage payments. The savings are estimated to be £300m for the private sector and £80m for the public sector.

The average annual savings are expressed at fixed in the table above. However, these vary across the years due to the impact of the transition period. See para 24 in the evidence base for an explanation on the distribution of costs. See para 24 in evidence base for explanation on distribution of flow of claims over the appraisal period.

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

Limiting how far the claims can go back reduces the time spent by businesses in estimating liabilities per employee. Cost savings are likely to be higher for firms that do not have the necessary systems to allow them to easily access information on historical overtime.

Key assumptions/sensitivities/risks

Discount rate (%)

3.5

The main assumptions of the analysis are as follows:

- Some employees working overtime might not be eligible to make a claim (for example, they might be working overtime on an adhoc basis) or they might already have overtime reflected in their holiday pay. We assume that 55-75% of employees who work overtime are doing so on a regular basis. Of these employees, we assume 27% get all of their paid overtime included in their holiday pay, and 8% only get part of the overtime included in their overtime in their holiday pay. These estimates are based on a business survey.
- Not all employees eligible for a claim will make a claim. We assume that between 5% of eligible employees will make a claim during the transition period and that between 10% and 35% (best estimate 22.5%) of eligible employees are likely to make a claim under backstop (under option 2). The cost savings to business (against the counterfactual) are sensitive to the take up rate estimates (especially the take up rate during the transition period).
- We do not have data on hours of overtime worked by employees and use the length of service of those working overtime in 2014 as a proxy of the past patterns of overtime worked. This assumes that the workers have displayed the same pattern of hours throughout their years of service and have continuously not had their overtime reflected in their holiday pay.
- We look at an appraisal period of 3 years as this impact assessment only concerns backdated claims (that were accrued from overtime worked in the past). Not all claims will be made in the first year (i.e. year 0). We allow claims to spill over to year 1 and 2 and thereafter we assume firms will be compliant with the law (and stopping claims coming forward).

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:				In scope of OITO?	Measure qualifies as
Costs: TBC	Benefits: TBC	Net: TBC			
				IN	OUT

Evidence Base (for summary sheets)

BACKGROUND AND PROBLEM UNDER CONSIDERATION

1. At present, if a worker is underpaid relative to what they are entitled to (for example because they have not been paid correctly for a period of holiday) they can bring a claim to the Employment Tribunal. However, if that underpayment has been going on for a long period of time, there is uncertainty about the retrospective time period the worker's Employment Tribunal claim could cover. This uncertainty has been highlighted by recent high profile court cases on holiday pay.
2. Until recently, many UK employers have paid holiday pay at the rate of a worker's basic pay and these arrangements had been considered acceptable under UK legislation and case law.¹ However, recent UK and European court cases have raised the issue of whether holiday pay should also reflect certain additions to basic pay such as non-guaranteed overtime, sales commission or airline pilots' pay supplements. The Court of Justice of the European Union (CJEU) rulings have implied that where such payments are 'intrinsically linked' to a worker's everyday job, then holiday pay should be increased to reflect them.
3. The most recent development on this issue is a judgment from the UK Employment Appeal Tribunal on 4 November 2014 in the case of *Fulton v Bear Scotland Ltd and Others* which sets out that payment for **non-guaranteed overtime** should be included in the calculation of holiday pay. Non-guaranteed overtime is overtime which a worker is required to do when asked by their employer, but which their employer is not obliged to offer. In addition, in May 2014 a ruling from the CJEU in the case of *Lock v British Gas* stated that sales commission should be reflected in the calculation of holiday pay.
4. Under current rules, workers can bring their holiday pay claims to the Employment Tribunal either directly under the working time regulations (WTRs) or as an "*unlawful deduction from wages claim*" under the Employment Rights Act 1996 (ERA).
5. Under the Working Time Regulations it is clear that claims can only go back in time by three months. However, in the ERA there is uncertainty about how far back in time a claim could go; there are reasons to believe this period is limited to six years, but there are also reasons (as many legal commentators have noted) to believe that claims could go back to when the Working Time Regulations were first introduced in 1998. The effect is that where workers have been underpaid over a number of years, employers may face paying arrears stretching a long way back in time.
6. Employer organisations have been vocal in their concerns about how damaging backdated holiday pay claims could potentially be to businesses, as press coverage illustrates. For example on the day after the ruling, many business organisations went public about their concerns, including the Confederation of British Industry (CBI), and the British Chambers of Commerce (BCC) in press releases². Many organisations have directly approached BIS to set out their concerns³.

¹ A key case was a Court of Appeal decision in 2004 (*Bamsey v Albon Engineering*)

² See for example: CBI press release: <http://www.cbi.org.uk/media-centre/press-releases/2014/11/cbi-comments-on-holiday-pay-ruling/> This is a real blow to businesses now facing the prospect of punitive costs potentially running into billions of pounds – and not all will survive ; BCC Press release <http://www.britishchambers.org.uk/press-office/press-releases/bcc-tribunal-pay-ruling-may-be-unbearable-for-businesses.html> "This ruling is damaging for businesses across the UK. Firms could be at risk of incurring significant financial losses, which could force them to close their doors altogether"

³ Numerous organisations have made representations, and CBI, EEF, IoD, FSB, BCC, BRC, GC100 and CECA are actively participating in a Government Taskforce on the issue.

7. The rulings are beneficial to individuals who regularly work overtime and trade unions have welcomed these rulings as positive. However, in workplaces where the use of paid overtime is widespread, and not already captured in holiday pay, employers could be facing large backdated claims. This impact is likely to be more concentrated in some sectors such as construction and manufacturing and means that there is a risk of job losses and business closures. The analysis section sets out more of the detail on the possible economic impacts.
8. This policy proposal does not seek to change individual entitlements looking forward, but it does look to change the ERA in order to limit the extent of liabilities faced by employers by making clear how far back in time such claims can go. Otherwise employers may face a large financial burden of backdated claims, despite believing they were following the law in good faith.

The relationship between the tribunal cases relating to overtime pay and the action the Government is proposing on limiting liabilities

9. The tribunal cases and the proposed action set out in this Impact Assessment are different, though obviously linked. The recent tribunal case has taken a position on the requirements of businesses to pay overtime as part of holiday pay in certain circumstances. Specifically the ruling was that:
 - Non-guaranteed overtime which a worker is required to work should be included in holiday pay.
 - Where a worker has been paid correctly for a 3 month period or more, any claim for arrears of holiday pay cannot go back in time before that period.
 - The UK Working Time Regulations can be interpreted and applied in line with this conclusion.
10. The Government's proposed action will not change that position. The proposed action is to change the law on recovery of previous underpaid wages in order to provide more certainty and to limit the financial burden arising from any backdated underpaid wages claims. Of course, we expect this will provide the greatest reductions in costs to those businesses with a potential liability arising from entitlement to overtime in holiday pay and sales commission in holiday pay, but its scope would also cover non-holiday pay related claims that a worker has not been properly paid wages they were entitled to. This would include, but is not limited to, commission, bonuses and claims to be paid the full national minimum wage. Though for claims under national minimum wage legislation, workers who have been underpaid here have other routes, and tend to use those – for example enforcement can be undertaken without cost to employees by Her Majesty's Revenue and Customs.
11. Waiting to take action would increase the total numbers of claims and the scale of each claim (as once claims are made in the Employment Tribunal they could potentially go back to 1998). Any delay in implementing this proposal brings more claims forward that are unrestricted, undermining the business benefits (the legislation cannot affect cases that are already in progress when it comes fully into force).
12. Government action will not extend what can be recovered as underpaid wages. The case law has created this change. Businesses believed they were compliant with the UK case

law prior to the recent judgment and they are now faced with a cost that was unforeseen and not inherent when the legislation was enacted. This action seeks to address that impact and bring more certainty to all parties about how far back their claims can go.

RATIONALE FOR INTERVENTION

13. The rationale for intervention is as follows:

- **To reduce the burden on employers of current regulation:** The proposed government action would continue to deliver the benefits of existing legislation with lower cost and uncertainty to employers. A claim from any individual worker or group of workers could entail significant costs without this action (see Table 1). The burden on small and medium sized businesses is likely to be high. Any businesses working on small profit margins but affected by this would also struggle to cope.
- **To provide certainty for employers and employees:** By intervening the Government is also creating an environment of certainty in the market which is particularly important in a case like this which involves significant sums of money for employers in times of economic recovery.

OBJECTIVES OF GOVERNMENT INTERVENTION

14. The Government has two main objectives:

- **Limit the burden on businesses:** The Government will achieve this by moving swiftly to limit the size of retrospective liabilities to employers. The proposed government action reduces the scope (and impact) of existing law and de-regulates compared to the backdating of liability provisions that potentially currently exist.
- **To provide certainty to employers and employees:** By intervening, the Government is also creating an environment of certainty in the market which is particularly important where such large sums of money are involved, and in times of economic recovery (as it helps business consider these costs for future planning and decision making).

15. Various options are considered that amend the Employment Rights Act 1996 to reduce the scope of liability by limiting how far claims can go back. To note, this impact assessment deals with the question of backdated claims and does not consider the impact of the EAT judgment more broadly. Our early estimates suggest that the Employment Appeal Tribunal judgment could mean additional future costs for employers in the order of £390 to £530m per year (see Annex A for detail on calculation and assumptions)⁴. This IA only considers government proposals to regulate on the issue of backdating overtime payments in holiday pay (i.e. claims potentially going as far back as 1998).

OPTIONS CONSIDERED

16. The Government considered the following options in coming to a view on the preferred way forward.

⁴ These increased future costs are derived from a tribunal ruling resulting in a change in the interpretation of existing regulation (rather than any regulation government has introduced) and hence these future costs to business become a part of the counterfactual.

- **Do nothing** – Under this option, the Government chooses not to intervene. If the Government does not introduce a backstop for holiday pay claims, there are two possible scenarios regarding how far claims for unlawful deductions from wages can go back –
 - Six years (in line with the Limitation Act 1980) ;
 - 1998 (Implementation of the Working Time Directive in UK).

Given the uncertainty, we consider claims can go back to 1998 in the do nothing scenario – indeed this is the contingency on which we understand a number of employers are working, and the basis for taking policy decisions. However, we also carried out further sensitivity analysis on a BAU scenario where claims only go back six years.

This is not the preferred option as it does not address the potential liabilities employers are facing, nor does it provide any certainty to employers. The liability faced by employers if claims went back to 1998 is likely to be £330m - £1.2bn (see Table 1).

- **Option 1** - Introduce a backstop period of 6 years without a transition period. This option would clarify in the ERA that claims for unlawful deductions could go back a maximum of 6 years (backstop period). The legislation would be made and would apply immediately (in other words there would be no transition period).

This is consistent with the Limitation Act 1980 (in England and Wales), and with claims made under the Equality Act. This is not the preferred option because although it provides certainty, it does not bring a significant reduction in the burden to employers potentially facing large claims. The liability faced by employers if claims went back six years is likely to be £200m - £700m (see Table 1).

- **Option 2** - Introduce a backstop period of shorter than 6 years with a transition period. This option would clarify in the ERA that claims for unlawful deductions from wages could go back a certain period of time less than 6 years. In making the period shorter we would need to provide a transition period – in other words a period of time where workers could bring their claim under current rules (potentially back as far as 1998). Without that protection there is no counterweight to workers having their claims potentially reduced in size with no notice of the regulatory change.

We considered various backstop options under 6 years, ranging from 3 months to 3 years. A short backstop risks impacting on other forms of unlawful deductions from wages, such as underpayment of the national minimum wage (although workers who have been underpaid the national minimum wage have other routes to redress and tend to use those). Conversely, a longer backstop would not bring significant benefits relative to option 1. We have also considered various lengths of transition period, and believe that a period of 6 months provides the best balance between worker protection and achieving the aims of limiting the burden of the claims. A two-year backstop with a 6-month transition period brings the best combination of reduction in burden on employers, certainty and avoidance of unintended consequences from impacts on other measures. The liability faced by employers if claims went back two years (with a six month transition period) is likely to be £250m - £450m (see Table 1).

ANALYSIS OF OPTIONS

17. The costs and benefits of option 1 and 2 are estimated relative to the counterfactual (do nothing) and consist of following components:

- Reduction in liability for employers from holiday pay claims – This includes savings to employers (private and public) from having to pay lower backdated overtime payments (these include wages and non-labour costs)⁵ under options 1 and 2 (compared to do-nothing) due to the introduction of a backstop which limits how far back claims can go.
- Impact on administrative burden for employers and exchequer - The analysis also estimates the likely administrative burden on employers (public and private) from introducing the regulation.
- Impact on other non-holiday claims – The analysis also explores the impact of potential liability arising from entitlement to sales commission in holiday pay, and also covers non-holiday pay related claims such as, potential claims to be paid the full national minimum wage, and other claims that a worker has not been properly paid wages they were entitled to under their contract.

Reduction in liability to employers (public and private) from holiday pay claims

Methodology and assumptions

18. Using data from Annual Survey of Hours and Earnings (ASHE) 2014⁶, business survey estimates (see Annex B) and set of assumptions we calculate the potential liabilities on business.

- I. First we estimate the annual overtime payment accrued to an individual over the 4 weeks of annual leave (EU entitlement)⁷. The overtime payments will consist of the total labour costs for the hours of overtime worked and will include both wages and non-wage labour costs (such as national insurance contributions and other pension contribution)⁸.

Yearly individual overtime payments (a) = median weekly overtime payment of the employee working overtime x 4 weeks of annual leave x 18.1% (uprate factor to account for non-wage labour costs)

According to ASHE, the median weekly pay for overtime is around £54 per week for a person working full time and £25 for someone working part time⁹. We use median overtime wage and not mean overtime wage as usually in labour market analysis median wages are taken as the best estimate of the average (however, we test these cost estimates by using mean wages when carrying out sensitivity analysis)¹⁰. To estimate the non-wage labour costs we uprate wages by a factor of 18.1%¹¹

⁵ Non-wage labour costs consist of 18.1% on top of wage costs. No wage labour costs encompass employers' social security contributions, vocational training costs, and other expenditure (such as recruitment costs, expenditure on work clothes, and employment taxes regarded as labour costs minus any subsidies received).

http://epp.eurostat.ec.europa.eu/statistics_explained/index.php?title=File:Labour_costs_per_hour_in_EUR,_2008-2012_whole_economy_excluding_agriculture_and_public_administration.png&filetimestamp=20130411095404

⁶ We use ASHE estimates instead of Labour force survey estimates as we consider ASHE more reliable for pay related data. Given the wage fluctuations we use 6 years average of ASHE data when looking at weekly overtime pay.

⁷ We estimate impacts based on 4 weeks that workers are entitled to under EU Working Time Directive rules, not the additional 1.6 weeks that workers in the UK receive as a domestic right, as this issue applies to EU leave.

⁸ No wage labour costs encompass employers' social security contributions, vocational training costs, and other expenditure (such as recruitment costs, expenditure on work clothes, and employment taxes regarded as labour costs minus any subsidies received).

⁹ ASHE Six year average 2009-2014. The weekly payments data take into account the hours of overtime worked in a week.

¹⁰ By using the median average pay we remove the effects of outliers on the average hourly wage (the mean is skewed due to presence of these outliers)

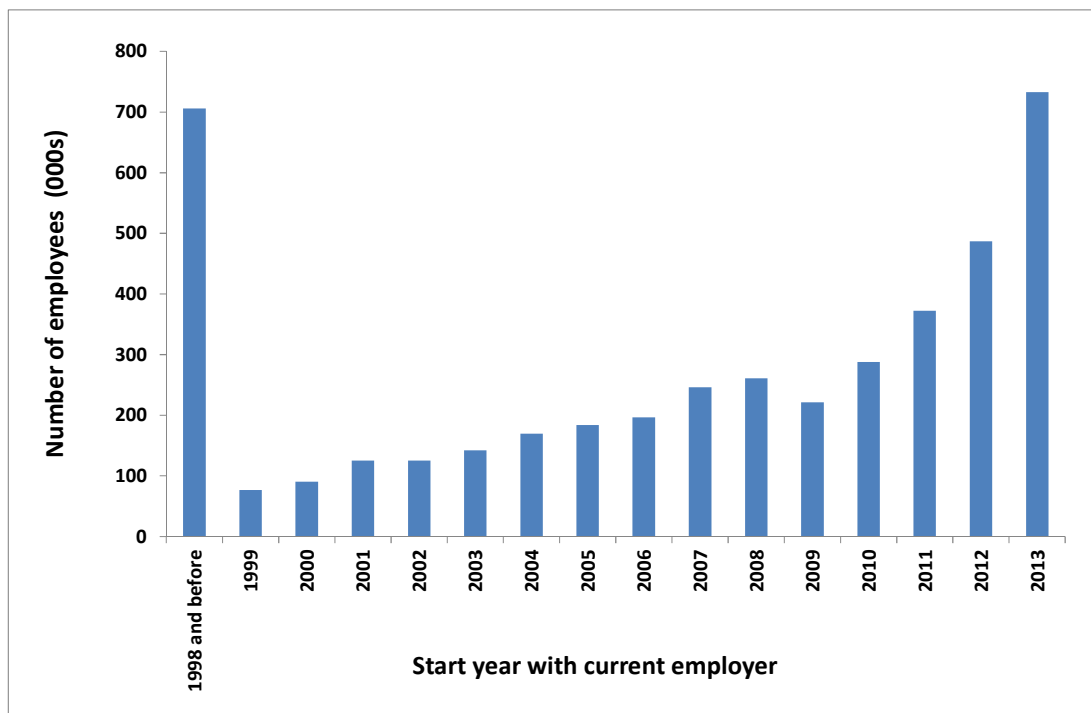
¹¹ http://epp.eurostat.ec.europa.eu/statistics_explained/index.php?title=File:Labour_costs_per_hour_in_EUR,_2008-2012_whole_economy_excluding_agriculture_and_public_administration.png&filetimestamp=20130411095404

- II. We then estimate the total overtime payment to the individual across their years of service. ASHE does not provide data on the *period of overtime worked* by individuals (over their period of service) but it does provide the length of employment of those who are working overtime in 2014. We use the latter as a proxy and assume that the workers display the same pattern of hours throughout their years of service and have continuously not had their overtime reflected in their holiday pay¹².

Total individual overtime payment accrued over the period (ya) = years of overtime worked (y) x yearly individual overtime payment (a)

As seen in the graph below, there is a sharp decline in the number of employees that remain with their current employer, as we go back in time. Please note there is a spike in 1998 as this category also includes all individuals who have worked continuously since before 1998.

Chart 1 – Distribution of length of service of employees who are getting paid overtime in 2014



Note that the EAT judgment itself contained a ruling that potentially reduces the above liability further. This is because it says that a 3-month or longer period of having been paid “correctly” breaks a series of deductions. In other words no worker would be able to bring a claim that stretched back beyond a period of 3 months or more where they were paid correctly, including cases where they had simply not taken any annual leave for that length of time. We expect that this should reduce the number of claims that stretch a long way back in time¹³

¹² This assumption is supported by the fact that a claim is enforced by the employment tribunal (ET). Currently a claim can only be brought to the ET within 3 months from the last in a series of deductions. Hence this would only include people who have been in continuous employment with the same employer for a period of time and have not had their voluntary overtime reflected in their holiday pay. For example, if an employee (Kevin) was being under paid between 2008 to 2011, he couldn't bring his overtime claim as it exceeds the '3 month limit'. Hence, total overtime accrued by individual will in turn depend on the length of service of the individual has with the current employer and the overtime accrued during the that period of time

¹³ However, this is open to change as further cases come before the UK ET and EAT and therefore it is still important to act swiftly and on the basis of the above estimates of liabilities. Furthermore, early feedback from Employer organisations from modelling work suggests it may not limit the size of claims as much as might be expected (especially for example in areas like skilled manufacturing where job tenure is longer and it is common to pay for overtime)

- III. Total overtime accrued to the economy is then calculated by *summing the overtime worked by individuals across the whole economy*. According to the Annual Survey of Hours and Earnings (ASHE) 2014, there are 4.63m employees that get paid for overtime. However, that is not the same as the number of workers that may be affected by this ruling. Some of these workers will not be affected because they already receive holiday pay that reflects their overtime. Some of these workers will not be doing regular overtime, or they may genuinely have a choice over whether or not they carry out overtime that their employer offers them (referred to in the EAT judgment as non-guaranteed overtime) – in which case arguably the ruling does not apply.

In summary, not all these individuals would have worked non-guaranteed overtime on a regular basis and some employers might already be including such overtime in the holiday pay. We have adjusted the figures to take into account these factors by carrying out a business survey of the proportion of employees that are likely to do "regular" overtime (the subject of these rulings) and the extent to which "regular" overtime is captured in holiday pay. For the purposes of the survey we defined regular overtime as - an employee would be considered to be doing "regular overtime" if he does extra hours (say 5 hours overtime) per week, consistently for one month. The survey suggested that of those businesses that pay for overtime only a proportion (between 55% and 75% with the midpoint as best estimate) pay for overtime that is regular in nature¹⁴. The survey also found that 27% of all businesses that pay regular overtime include all of this in the holiday pay, 8% state that they include part of it. Annex B provides further information on the survey.

Total overtime payment accrued over the period (T_{ya}) = (sum of individual overtime over the period x proportion of employees working overtime on a regular basis (r %) x proportion of these employees who do not have overtime reflected in their holiday pay (c %))

- IV. Not all individuals who are due overtime will make a claim. There are various factors that will influence whether an individual will make a claim and hence in reality take-up will be less than 100%. The uptake rate will depend on various factors – such as: how aware the employee is of the issue, whether they are consistently recording their overtime, whether they would be willing to potentially damage relations with the employer by going to the employment tribunal if an overtime claim is denied, or whether they are willing to pay an ET fee. There is also the possibility that some businesses will just pay these claims to ensure good relationships with their staff.

For these reasons it is challenging to estimate take-up of overtime claims. To inform such an assumption, we have looked at evidence on Payment Protection Insurance (PPI). Existing evidence state take up rate of PPI claims to be roughly to be 35%¹⁵. We use this as a high estimate for the purposes of estimating the costs of overtime claims. This is because PPI claims were advertised extensively with straightforward claims procedures.

¹⁴ Survey results stated that on average 55% of all businesses pay for regular overtime. However, the survey results also showed that larger employers are more likely to pay regular overtime. The business survey stated 71% of firms employing between 51 to 250 workers are likely to pay for regular overtime and 75% of firms employing over 250 workers are paying for regular overtime. ASHE data states that over 80% of the employees working overtime are employed in large organisations employing more than 50 workers, Hence we choose a range 55% to 75% to ensure we do not underestimate the costs and consider the impact of larger firms.

¹⁵ It is hard to estimate the take-up rate of PPI claims as there is very little evidence on the proportion of the misold PPI. Currently there are still claims being submitted. According to FCA report on Thematic Review of PPI complaints, around 45m policies were sold between 1990 and 2010 and 13m complaints were made since 2007 (35% assuming one complaint is made per policy sold). Also, the 45m policies sold accounted for £45bn in premiums and so far £16bn has been paid to consumers (roughly 35% though not all the £45bn would constitute mis-sold PPIs). <http://www.fca.org.uk/news/tr14-14-redress-for-ppi-mis-sales>. According to JGFR publication release, roughly two thirds of adults who took out PPI policies are likely to make a claim, and Thematic review report mentions that 70% of these claims are likely to be upheld in favour of the consumer (estimating a estimates the rate of a successful claim to be roughly 45%). http://www.jgfr.co.uk/files/PPI_press_notice_jgfr.pdf

It is likely that the awareness will be lower for overtime payments as the extensive methods used for PPI to raise awareness (firms had to take steps to make PPI claims easy) will not be deployed for overtime claims. Also, it can be argued that overtime workers are likely to face bigger hurdles or barriers while making a claim. For example, to make a holiday pay claim, workers will have to pay an Employment Tribunal fee, they may also jeopardise working relations with their employer. Also, it is the worker's responsibility to prove that they have a holiday pay claim in the employment tribunal (albeit that they may be helped by their employers' records). Hence for the purposes of the analysis, we consider an uptake rate of around 10%¹⁶ - 35% (best estimate 22.5%) for the do nothing and option 1, and for the backstop but not the transition period in option 2. Given the uncertainty we carry out further sensitivity analysis on the take up rate¹⁷.

The transition period is introduced before the backstop and it allows employees to bring forward claims that go beyond the backstop (and potentially as far as 1998). For the transition period we assume the take up rate to be 5%. This is for two reasons. Firstly, the transition period would last for only six months and hence we assume the take up rate to be lower than the backstop (as the latter will allow more time for employees to bring forward a claim with the necessary supporting evidence)¹⁸. Secondly, as discussed above the various hurdles to make a claim (i.e. negative impact on employer relations, time costs of going through ACAS and Employment Tribunals)¹⁹ will need to be considered by the employee during this short transition period when they bring forward a claim and will affect their decision on whether the pay-off from winning a claim exceeds the costs of making a claim. ASHE 2014 data state that over a majority of claimants (76%), who work overtime, earn between £10K and £42K²⁰. The weekly overtime of this category is £47 per week which estimates 8 years of overtime to be £1500 (net of tax £1200). Costs to a claimant from an employment tribunal is £1800 (case went to tribunal hearing) or £1100 (ACAS settled)²¹. These figures exclude Employment Tribunal fees which are sometimes recovered by successful claimants by application to the Tribunal. Employment Tribunals rarely issue cost orders for other expenses, and so it is likely that claimants would bear most of the aforementioned costs themselves. Only where the duration of overtime is very long (involving substantial payments) it is economically beneficial for an individual to make a claim. These cost estimates do not include the negative impact of hampering employee employer relations and this would make the estimates even lower.

However, if these hurdles are reduced via schemes such as 'no win no pay' (or class action enabling individuals to make a claim easily²²) and employees are made more aware of their right to claim then the take up is likely to be higher²³. We carry out further sensitivity analysis on take-up rate.

¹⁶ While we assume take-up of overtime claims to be lower than the PPI claims, we do not think this would be zero as it is quite likely there will be claims made. So we assume 10% take up rate as the lower end of the range.

¹⁷ It can be argued that PPI is not an appropriate comparator for estimating take up rates. While overtime claims might not be advertised as extensively as PPI claims implying a low take up for the latter, it could be conversely argued that PPI consumers might not know if they are eligible (as PPIs are complicated insurance product) implying a lower take up compared to overtime claimants (who arguably would be more aware of overtime wages). Hence it is important to test the sensitivity of the rates assumed.

¹⁸ It can be argued that the take up rate of the backstop under Option 2 is endogenous and dependant on the take up rate of the transition period. For example, the higher the take up rate during the transition period the higher will be the take up rate of the backstop following the transition. However, for simplicity purposes we assume a take up rate under the backstop of 10% to 35% (same as option 1 and do nothing)

¹⁹ Also note there is less incentive for individuals to put in a one year or two year claim if the hurdle to make a claim is high.

²⁰ The median pay for this group £23K

²¹ These estimates include time spent on case, costs for advice and representation, costs incurred for travel and communication.

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284042/bis-14-585-early-conciliation-impact-final.pdf

²² Also employers decides to pay the amount of the claim in good faith without the employee having to go to an Employment Tribunal

²³ In addition it could be argued that with a short transition period there will be a rush to make claims as the period comes to an end, spiking up the rate of claims.

- V. These estimates include costs to all employers (both private and public sector). Based on 2014 ASHE estimates, 80% of the costs are borne by the private sector and 20% by the public sector.

Other assumptions

19. We finally assume that the wages (non-labour costs such as NICs) have remained unchanged over the assessment period. We look at 6 year average (ASHE 2009 to ASHE 2014) when using weekly overtime data to smooth out fluctuations in the data and to account for the wage variation²⁴.

Analysis

20. The following analysis refers mainly to capturing overtime in holiday pay. It is also important to note that there is now a European Court judgment on including sales commission in holiday pay. This is in turn leading to claims for backdated holiday pay, but the situation is less certain as the UK ET still needs to consider the matter in early 2015. Hence it has not been possible to estimate these costs for the purpose of our analysis. However, compared to overtime these costs are likely to be low as sales commission is received by fewer workers²⁵. However, we note that employer organisations still think this will be a difficult and costly issue.
21. Using the methodology and assumption stated we derive the cost savings from holiday pay claims and these are presented in Table 1 below. Note the table below only presents one scenario under option 2B (2 year backstop with six month transition period). Results for option 2A (1 year backstop with six months transition period) and 2C (3 year backstop with six month transition period) are presented in Annex C.

Table 1 - Cost savings (undiscounted) to employers from holiday pay claims

Options	Liability on all employers (savings from 'Do Nothing')	Liability on private sector employers (savings from 'Do Nothing')	Liability on public sector employers (savings from 'Do Nothing Scenario')
Maximum liability: (100% take up)	£3.3bn	£2.65bn	£660m
Do nothing (considered as counterfactual for analysis): Do nothing (10 to	£330m – £1.2bn Best estimate: £750m (midpoint)	£265m-£930m Best estimate: £600m	£65m -230m Best estimate: £150m

²⁴ Based on Chart 1, over a majority of the claimants would have worked for 6 years or less so we use a six year average. Taking an average over a longer timeframe would underestimate the costs.

²⁵ According to the LFS, less than 2% of all people in employment receive commission or sales bonus as part of their bonus pay.

35% take up)			
Option 1	£200m - £700m	£160m -560m	£40m -£140m
6 year back stop (10-35% take up)	Best estimate: £450m Savings: £300m	Best estimate: £360m Savings: £240m	Best estimate: £90m Savings: £60m
Option 2B	£250m – £450m	£200m-360m	£50m-£90m
2 Years transition (5% take up) + backstop (10- 35% take up)	Best estimate: £350m (5% transition; 22.5% backstop) Savings: £400m	Best estimate: £280m(5% transition; 22.5% backstop) Savings: £320m	Best estimate: £70m(5% transition; 22.5% backstop) Savings: £80m

22. From the table above we can see that under 'Do nothing' scenario the maximum liability for employers is estimated to be £3.3bn for 4 weeks of annual leave. This maximum liability is calculated using a 100% take up rate (i.e. all workers with a claim bring it to the ET successfully). In reality the take up rate will be lower and we use a take up rate of 10% to 35% for our central best case scenario (see paragraph 18 'assumption IV' for rationale behind using this take up rate). The liability on employers for this scenario is estimated to be between £330m to £1.2bn. This is the baseline against which the savings are estimated for Option 1 and 2.

23. The liability is likely to be reduced under Option 1 as introducing a backstop allows claimants to only go back six years when making a claim and prevents claimants from claiming as far back as 1998. Based on 10-35% take-up rate the liability under this option 1 (6 year backstop no transition) is estimated to be £200m to £700m for 4 weeks. Compared to the do-nothing scenario the best estimate savings under Option 1 is estimated to be £300m²⁶. Under Option 2, the liability under this on employers varies according to the length of the backstop. For a backstop of 2 years and a six month transition period (Option 2B), the total liability is estimated to be £250m to £450m, with best estimate savings of £400m compared to the do-nothing scenario.

24. We look at an appraisal period of 3 years as this impact assessment only concerns backdated claims (that were accrued from overtime worked in the past). It is likely that not all claims will be made in the first year (i.e. year 0) when the policy is introduced. We allow claims to spill-over to year 1 and 2. Beyond this period we assume firms will be compliant with the law and backdated claims will stop coming forward. There is very little evidence to help us understand the likely distribution of claims over the appraisal period. Given the uncertainty, we assume that numbers of claims made will be equally distributed across the 3 years for option 1 and the do nothing. For example, for the best estimate take up of 22.5% this would mean 7.5% take-up across each year. For option 2 there will be 5% take up during the transition period plus and 7.5%²⁷ take up during the backstop for year 0, year 1 and 2. The estimates in years 1 and 2 are discounted using 3.5% discount rate as per Treasury Green Book Guidance²⁸. The net present value of savings to employers (which are equivalent to losses to employees) is estimated to be

²⁶ This estimate is calculated by subtracting the option 1 'best estimate' cost from do nothing 'best estimate' costs.

²⁷ Note the 7.5% take-up will be on remainder of the pool of claims (i.e. after netting off 5% of claims made during the transition period)

²⁸ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220541/green_book_complete.pdf

£130m to £450m (best estimate £290m) for option 1 and £80m to £680m (best estimate £380m) for option 2.

25. These payments are savings to employers and loss to employees (transfer payments). However, not all of these estimated payments in table 1 will accrue to the employees, as they will have to pay tax on these backdated overtime payments. The loss to exchequer (from lower backdated overtime payments to employees) is estimate to be £25m to £90m (best estimate £56m) under option 1 and £15m to 134m (best estimate £74m) under option 2B.

Familiarisation costs to businesses

26. There will be familiarisation costs to employers (public and private) from understanding whether the changes in the law would affect them. Under the do-nothing this includes the costs to employers of understanding the EAT judgment²⁹. BIS officials have had meetings with payroll providers, accountants, as well as employers themselves. Based on these discussions we understand that a lot of work is already going on to try to understand the EAT judgment and these costs are estimated to be high. Under option 1 and 2, there will be an additional one off costs to employers to familiarise themselves with the fact that any claims against them would go back six or two years instead of potentially back to 1998. We assume the latter will take one hour of HR time³⁰, as the main costs to business will be to understand the implication of the change in the case law and not of this relatively straightforward government action. The average hourly pay of a Human Resource officer is £23 (or £27 of total labour costs which includes non-wage payments) according to ASHE data³¹. There are 4.98m businesses (public and private) in the whole economy³². Only the proportion of firms that are affected by the EAT judgement will face the additional familiarisation cost from Government bringing in new regulation. We scale down the number of firms by the proportion of employees that are likely to be impacted by the legislation (8%³³ of 4.98m). The one off familiarisation costs are estimated to be £10m (derived by multiplying the number of firms affected by the hourly HR earnings).

27. By introducing a backstop, the Government will provide clarity to businesses and reduce the costs of getting legal advice on how the judgment will work in practice. This is because it creates more certainty regarding the length of time for which liabilities are payable. Given our evidence base, it has not been possible to estimate this benefit³⁴.

28. In addition limiting how far the claims can go back, the proposed action will reduce the time spent in estimating liabilities per employee. However, the extent of such cost savings will differ according to firms and their ability to retrieve the information on overtime payments across previous years. Cost savings are likely to be high for firms if they do not have the necessary (IT) systems set up that allow them to access the

²⁹ There will also be costs to respondents from making a claim, government from processing the claim and employers from responding to the claim

³⁰ The time spent could vary from 10 minutes to a day or two as it depending on the legal expertise/resource of the firm. Also, some employers will have access to legal advice from representative bodies such as EEF or CBI. However based on previous labour market Impact Assessments (for example, Zero Hour Contract) we use an hour of familiarisation costs.

³¹ 6 years average (SIC code - Human Resource managers and directors (1135)), 2009-2014

³² Table 2 of the 2013 Business Population Estimates dataset. <https://www.gov.uk/government/statistics/business-population-estimates-2013>

³³ Roughly 2m workers and employees working overtime and not getting this reflected in holiday pay. This estimate is arrived at by after taking into account roughly 55%-75% of those working overtime (4.6m) work overtime on a regular basis and 27% have all of their overtime included in holiday pay and 8% only have part of their overtime included. There are 27m employees working in the 4.98m businesses and 2m account for roughly 8% of this pool of employees.

³⁴ Solicitor's fees may vary significantly with seniority, location and complexity of employers salary arrangements. Also, some employers will have access to legal advice from representative bodies such as EEF or CBI.

information readily. It will be low for firms who already have systems set up that allow them to estimate these liabilities. Again, given our evidence base, it has not been possible to estimate this cost saving.

Impact on Non-Working Time Regulation rights based claims

- 29. The proposals apply to claims for unlawful deductions from wages. This could be any money payable to a worker as a result of their employment which *should* have been paid but was not. Relevant wages for the purposes of these provisions are defined by section 27 of the ERA and include “any sums payable to the worker in connection with their employment, including any fee, bonus, commission, holiday pay or other emolument referable to the worker's employment, whether payable under their contract or otherwise”. This includes holiday pay, but the wide scope of the definition also covers claims for underpayment contrary to contractual rights and claims for underpayment of the National Minimum Wage.
- 30. Under the do nothing scenario, the limitation provisions covering these claims are the same. If the courts were to decide to hold that the Limitation Act 1980 applies, then the limit would be a maximum of six years. If not, then claims could run back for as long as the relevant right has existed (in both cases provided a ‘series of deductions’ can be established). The proposed changes would therefore represent a reduction in the potential liability for arrears payments under other types claims for unlawful deductions from wages.
- 31. Options 1 and 2 would limit arrears that could be paid for a range of other cases. At the current time there are no other issues than holiday pay driving large backdated claims. Although this will impact on claims under national minimum wage legislation, workers who have been underpaid here have other routes, and tend to use those – for example enforcement can be undertaken without cost to employees by Her Majesty’s Revenue and Customs.

SENSITIVITY ANALYSIS

- 32. We look at sensitivity of the cost estimates to using mean wages instead of median, changes in take up rate and changing the length of claim to six years under the baseline. Note all the estimates presented are discounted costs and savings.

Scenario – Using Mean wages instead of median wages

- 33. The median weekly overtime payments/wage according to ASHE estimates is £45 per week³⁵. The mean overtime wage is £89 for full time worker and £45 for part time worker per week. As we see from the table using the mean wages substantially increase the value of the estimates, however the rankings of the option do not change. The best estimate liability on businesses under the do nothing scenario is estimated to be £1.2bn, the savings to business is estimated to be £490m and £660m under option 1 and 2B respectively.

Table 2 – Sensitivity analysis using mean wages

Options	Liability on employers (savings from Do Nothing)
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³⁵ This estimate is reliant on the median hours of overtime worked in a week. According to ASHE estimates it is roughly 4 hours.

Maximum liability: (100% take up)	£5.5bn
Do nothing (considered as counterfactual for analysis): Do nothing (10 to 35% take up)	£550m – £1.9bn Best estimate: £1.2bn (midpoint)
Option 1 6 year back stop (10-35% take up)	£330m – £1.15bn Best estimate: £740m Savings: £490m
Option 2B 2 Years backstop transition (5% take up) + backstop (10-35% take up)	£410m – £740m Best estimate: £570m (5% transition; 22.5% backstop) Savings: £660m

34. Results for option 2A (1 year backstop with six months transition period) and 2C (3 year backstop with six month transition period) are presented in Annex C.

Scenario – Increasing the take-up rate for the transition period and backstop

35. To calculate the best estimate we assume 22.5% uptake rate for the backstop and a 5% uptake rate for the transition period (under option 2). The estimate is sensitive to this assumption. We see from the table below that on increasing the take up rate to 20% in the transition period, the liabilities that business face is higher under option 2B (£820m) compared to option 1 (£450m). This makes option 1 more beneficial to business compared to option 2B. Also under this scenario we see that option 2B has negative savings (-£70m) compared to the do nothing best estimate.

36. However, we still consider 5% take-up during the transition period as the best estimate as a) the transition period is for 6 months only, b) it is the worker's responsibility to prove that they have a holiday pay claim in the employment tribunal (albeit that they may be helped by their employers' records) and c) the employee will weigh the challenges (which will involve time, money and could potentially damage relations with the employer) of making a claim against the benefits from winning a claim. Based on ASHE, the size of an individual claim is likely to be a few hundred pounds (see assumption IV, paragraph 18) which might de incentivise employees to make a claim during the transition period.

Table 3 – Increasing the take-up rate for the transition period

Options	Liability on employers (savings from Do Nothing)
Maximum liability: (100% take up)	£3.3bn
Do nothing (considered as counterfactual for analysis): Do nothing (10 to 35% take up)	£330m -£1.2bn Best estimate: £750m (22.5% take up)

Option 1 6 year back stop (10-35% take up)	£200m - £700m Best estimate: £450m Savings: £300m
Option 2B 2 Years backstop (10-35% take up) + transition (20% take up)	£730m – £900bn Best estimate: £820m Savings: - £70m

37. We also considered the effect of increasing the upper range of the backstop take-up rate to say 50% for do nothing scenario, option 1 and option 2 backstop period (with a 5% transition take-up). This increases the best estimate cost under the do-nothing scenario to £1bn but importantly the relative positions of options 1 and 2B remain unaltered with best estimates of £600m and £410m giving savings of £400m and £590m respectively.

38. Results for option 2A (1 year backstop with six months transition period) and 2C (3 year backstop with six month transition period) are presented in Annex C.

Scenario – Claims go back six years under the do-nothing

39. The table below looks at a scenario where claims can go back six years under the baseline (do-nothing). In such a case, Option 1 and do nothing become identical. Under option 2 during the transition period claims can only go back six years (as is the case under the do-nothing). The liability on employers is lower under this scenario and for option 2B employers' liabilities amount to £280m (and £170m savings compared to the baseline).

Table 4 – Claims go back six years under the do-nothing

Options	Liability on employers (savings from Do Nothing)
Maximum liability: (100% take up)	£2bn
Do-nothing/Option1 6 year back stop (10-35% take up)	£200m – £700m Best estimate: £450m (midpoint)
Option 2 2 Years backstop (10-35% take up) + transition (5%)	£180m – £380m Best estimate: £280m (5% transition; 22.5% backstop) Savings: £170m

40. There is a reduction in in magnitude of savings across option 1 and 2 (compared to the scenario where the baseline allowed claims to go back to 1998 – table 1) but it is not substantial. This is because based on the length of service of workers working overtime (ASHE 2014), majority have worked overtime less than 6 years (see as depicted under chart 1).

41. Results for option 2A (1 year backstop with six months transition period) and 2C (3 year backstop with six month transition period) are presented in Annex C.

FUTURE ENFORCEMENT

42. The proposed changes will not affect the way in which claims of this nature are enforced. As now, if workers bring a claim, they will first need to go into Early Conciliation with ACAS³⁶. If the issue remains unresolved they may bring an Employment Tribunal claim³⁷.

MONITORING AND EVALUATION:

43. Although positive for individual workers, there are significant financial implications following the EAT judgment. To understand these impacts and find solutions to mitigate burden on business we have set up a taskforce. These proposals and our contextual analysis have been informed by discussions with the taskforce. However, this IA does not assess the impacts on the court case but considers the impact of the targeted intervention which intends to reduce risks and uncertainty. There is uncertainty associated with extent to which the estimated impacts will be realised in reality and we will monitor these impacts as a part of our wider on going evaluation of the impact of the Working Time Regulations.

RISK SECTION:

44. The analysis here is predicated on an uncertain and changing picture with UK and European Case law. It also necessarily makes assumptions about worker and employer behaviour. Assumptions have been set out in the analysis and sensitivity analysis carried out to reflect the uncertainties. A key risk is that as a result of the backstop workers bring forward claims quickly in the transition period to such an extent that there are no overall savings to employers. Our engagement with employer representatives suggests that the future certainty on liabilities that these changes will provide mean that there is still benefit in proceeding.

ONE-IN, TWO OUT

45. This impact assessment is published to inform the action the Government is taking. This Impact Assessment does not specifically address the impact of the proposals on OITO.

SMALL AND MEDIUM BUSINESS ASSESSMENT

46. The proposed Holiday Pay measure is intended to reduce the burden on business by limiting retrospective liabilities. The do nothing scenario will place a disproportionate impact on small and micro business who may struggle to absorb any increased liabilities. Our analysis uses survey data (ASHE) to estimate the number of individuals working overtime but we are not able to link this information to identify figures by business size. However based on ASHE data and assumptions, we can provide estimates to demonstrate the financial burden of the proposal on all small and micro businesses affected. The do nothing cost best estimate of £750m. By apportioning costs by proportion of employees in the private sector cost by proportion of overtime employees

³⁶ <http://www.acas.org.uk/index.aspx?articleid=1461>

³⁷ Using most recent HMCTS quarterly tribunal statistics, 12% of Unauthorised Deductions and 17% of Working Time claims that entered the Employment Tribunal system ended up at an Employment Tribunal hearing in 2013/14.

working in micro and small (15%) we are able to estimate that £90m of costs will fall on will fall on small and micro business. Under the proposal we have a reduced 2-year liability of approximately £40m on small and micro business (using the same methodology as above), which results in savings of £50m across all small and micro businesses.

FAMILY TEST

47. On balance we consider that this government proposed measure on limiting backdated holiday pay will have a neutral impact on families as some reductions in back pay are foregone to ensure job and wage security. Government policy by swiftly moving to limit the size of the retrospective liabilities to businesses and civil organisations reduces the scope (and impact) of existing regulation law (based on the ruling from the Employment Appeals Tribunal case) on employers who are likely to face large financial burden of backdated claims. As the measure reduces the likely historic payments firms will have to make to employees (who have been working overtime regularly in the past), this is expected to prevent small businesses from having to take material steps towards reducing the workforce or future wages (given these unexpected additional financial commitments). This will in turn help provide job and wage security for employees. However, on the flip side of this, some employees will be entitled to lower 'historic' income payments under the measure (compared to the do-nothing). We do not think that loss of these payments will outweigh the benefits of greater job and wage security in the round.

EQUALITY ANALYSIS

48. The analysis in this section mainly compares the proportion of employees undertaking overtime broken down by protected group versus the proportion of employees in each protected group in the labour market. Due to data limitations we are not able to look directly at those affected by this policy change i.e. those receiving paid overtime who could be entitled to payments beyond two years, with the exception of age and gender.

49. BIS have analysed the potential impact that this regulatory change could have on the protected groups defined in the Equality Act 2010. The groups that appear to be disproportionately affected are:

- Males - who comprise over 60% of overtime workers yet make up around half of all employees;
- Those aged between 40-60; and
- Individuals whose disability is defined as current disability only.

50. The use of a transitional period will allow the opportunity for those who feel they have a claim to come forward, mitigating any potential disproportionate impacts.

Data

51. The Annual Survey of Hours and Earnings (ASHE) is our primary data source to identify all those receiving paid overtime (4.63m³⁸). There is however limited personal characteristics information contained within ASHE with the exception of age and gender.

³⁸ This is the base figure prior to applying any of our assumptions which reduces the number to around 2m.

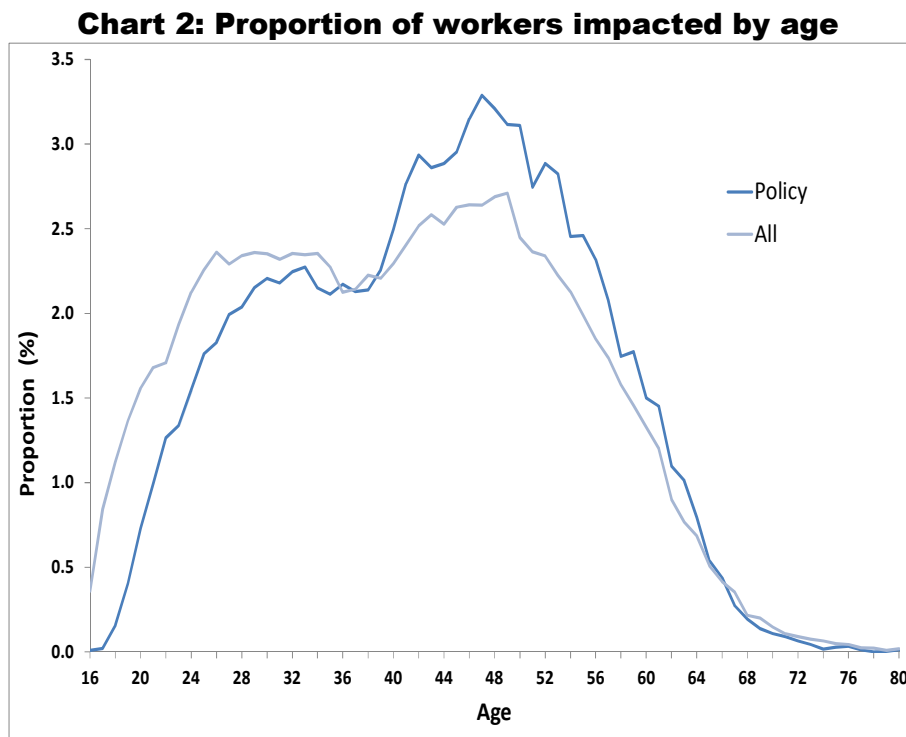
52. We have used additional survey data, specifically the Labour Force Survey (LFS) to look at other protected characteristics. There are however limitations arising from having to use LFS data, primarily due to its self-reported nature, which differs from ASHE³⁹.

Analysis

53. The following analysis provides more detailed information for the protected characteristics. For Age and Gender we use ASHE data to compare employees that are affected by the proposed regulatory change. For other protected characteristics, we are unable to use ASHE as it does not collect this information. For the following four characteristics (race, religion, disability, marriage and civil partnership) as a proxy we are able to use LFS data where the survey respondent answered 'yes' to the question 'have you ever worked overtime (paid or unpaid)?' Around 1/3 answered that they have worked overtime.

Age

54. Chart 2 illustrates the age distribution of those affected by this policy change. It compares this group to the distribution for all workers and shows a negative impact of the policy for those aged 40-60, but especially the group aged in their mid-40s to mid-50s. This age group make up a larger proportion of those entitled to overtime payments when compared to all workers.



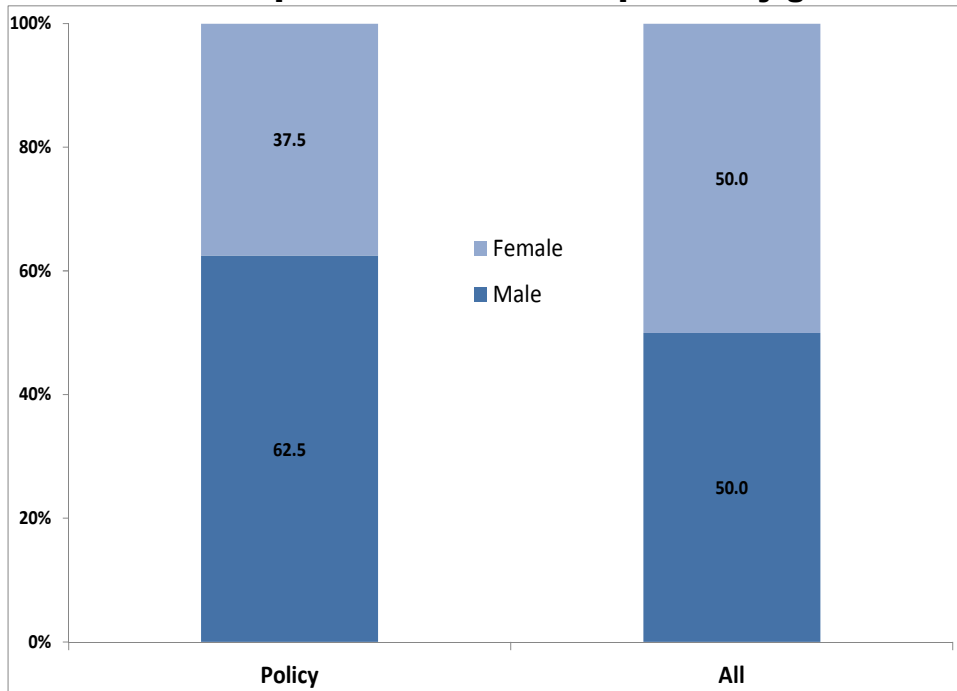
Source: ASHE 2014

Gender

55. Chart 3 illustrates the proportions of those affected by this policy change compared to all workers by gender. It indicates an apparent negative gender impact on males.

³⁹ ASHE data is a 1% sample of HMRC PAYE information.

Chart 3: Proportion of workers impacted by gender



Source: ASHE 2014

Race

56. Table 5 below compares those that have worked overtime with all workers. It shows that the proportion of overtime workers that are white is slightly higher than the proportion of all workers that are white. For other ethnic groups the proportion of overtime workers is the same or less than all workers.

Table 5: Proportion of workers impacted by Race and Ethnicity

	White	Asian or Asian British	Black or Black British	Mixed	Chinese or other Ethnic group
Overtime workers	92.1	3.2	2.3	0.9	1.5
All workers	89.8	5.1	2.5	1.0	1.6

Source: LFS January – March 2014

Religion

57. Table 6 compares data by religion and appears to show that there are no religious groups that are significantly impacted by this policy. The largest difference is for those stating no religion which is higher for overtime workers compared to all workers.

Table 6: Proportion of workers impacted by religion

	Christian	Muslim	Hindu	Sikh	Jewish	Buddhist	Any other religion	No religion
Overtime workers	56.0	1.6	0.9	0.7	0.5	0.3	1.4	38.8
All workers	56.3	2.7	1.6	0.6	0.4	0.5	1.4	36.5

Source: LFS January – March 2014

Disability

58. Table 7 compares data by disability and shows a higher proportion of overtime workers who fall under current (DDA)⁴⁰ disability definitions only compared to all current disability defined workers. Current disability includes those who have a long-term disability which substantially limits their day-to-day activities. Work-limiting disabled includes those who have a long-term disability which affects the kind or amount of work they might do.

59. Other disability groups (those both current disability and work-limiting disabled and those whom are work-limiting disabled only) are at similar or reduced rates when looking at the proportion of those working overtime. If we were to take all disability categories as a whole it would show there is almost no difference between overtime workers and all workers.

Table 7: Proportion of workers impacted by Disability

	Current disability and work-limiting disabled	Current disability disabled only	Work-limiting disabled only	Not disabled
Overtime workers	5.8	5.2	1.8	87.3
All workers	6.6	4.7	1.6	87.1

Source: LFS January – March 2014

Marriage and civil partnership

60. Table 8 looks at marital status and shows a slightly higher proportion of overtime workers who are married compared to all married workers. Other groups are at similar rates when comparing proportions of those working overtime to all workers.

Table 8: Proportion of workers impacted by marital status

	Single, never married	Married, living with husband / wife	Married, separated	Divorced	Widowed	Civil partner	Other
Overtime workers	35.2	52.0	2.6	8.7	1.0	0.4	0.0
All workers	37.8	49.5	2.8	8.3	1.3	0.4	0.0

Source: LFS January – March 2014

Other protected characteristics

61. Maternity statistics are published annually in England by the Health and Social Care Information Centre. Data for 2012-13 show there were 670,000 deliveries of which the vast majority (90%) were to 20-39 year olds. Chart 3 above illustrates the gap between numbers of male and female workers which can be partly explained by pregnancy.

62. Labour Force Survey data shows around 400,000 people claimed to be working fewer hours when questioned due to being on maternity / paternity leave. Of these around 1 in 3 claimed to have worked overtime. However it is not possible to establish whether there is any disproportionate impact on this group.

⁴⁰ DDA – Disability Discrimination Act. This was replaced by the Equality Act 2010 but data within LFS still identifies DDA disabled as a response.

63. There is little data published on both gender reassignment or sexual orientation. Separate papers published by the Office for National Statistics (ONS)⁴¹ acknowledged the information gap and tried to suggest ways forward. On gender reassignment, ONS scoping work suggested the use of a combination of attitude surveys, administrative data and specialist surveys to more adequately fulfil user requirements.
64. Data published in a report by the Gender Identity Research and Education Society (GIRES)⁴² in 2009 estimated that there may be between 300,000 and 500,000 people who experience some degree of gender variance. By 2010 the number of people estimated to have presented for transition treatment was 12,500 and thought to be growing at a rate of 11% per annum. The median age for treatment was 42.
65. ONS' paper which considered inclusion of a sexual orientation question for the 2011 Census⁴³ used a figure of 5-7% of the population which Stonewall⁴⁴ felt was a reasonable estimate. The absence of robust data for these two characteristics means that we are unable to establish whether there are any disproportionate impacts on these groups.

⁴¹ <http://www.ons.gov.uk/ons/guide-method/measuring-equality/equality/equality-data-review/trans-data-position-paper.pdf>

⁴² <http://www.gires.org.uk/assets/Research-Assets/Prevalence2011.pdf>

⁴³ <http://www.ons.gov.uk/ons/guide-method/measuring-equality/equality/sexual-identity-project/2011-census-consultation--background-information-on-sexual-identity.pdf>

⁴⁴ The lesbian, gay and bisexual charity - <http://www.stonewall.org.uk/>

ANNEXES

ANNEX A - CALCULATION OF FUTURE CLAIMS

We estimate future claims based on ASHE data. According to ASHE 2014, there are 4.63m employees that get paid for regular overtime¹. According to ASHE, the median weekly pay for overtime is around £54 per week for a person working full time and £25 for someone working part time². The costs to employers is calculated by multiplying the number of employees affected with the median weekly overtime pay and 4 weeks of annual leave. However, much paid overtime is contractual or in some other way already captured in holiday pay and ASHE estimates do not account for this. We carried out a business survey (see Annex B) to try to find out more about “regular” overtime (the subject of these rulings) and the extent to which “regular” is captured in holiday pay. For the purposes of the survey, the following definition of regular overtime was used - an employee would be considered to be doing ‘regular overtime’ if he does extra hours (say 5 hours overtime) per week, consistently for one month. This suggested that of 55% to 75% of the businesses that pay overtime pay “regular” overtime (larger businesses tend to pay more overtime). The survey also states that 27% of all businesses that pay regular overtime include all of this in the holiday pay; 8% state that they include part of it. Using these survey estimates³ the wage costs to business account for £390m to £530m for 4 weeks.

While inclusion of paid regular overtime in future holiday pay will increase the wage bill to employers, the overall impacts the economy will depend on a how the firms will react to absorb the increase in costs of labour, and are relatively uncertain. Being faced with higher labour cost, businesses are likely to respond by one or a combination of the following measures – 1) reducing the hours worked, 2) cutting back on future pay increase 3) adopting avoidance measures (for example, under reporting overtime worked), 3) increase their product prices and/or 4) by reducing profit margins. The overall impact will depend on which of these impacts will dominate and by what extent. The ongoing costs are likely to be lower as firms will have the opportunity adjust their behaviours (for example, by reducing opportunities for overtime) which could minimise any negative effect on employment. However, backdated claims will impose an additional burden on business. Government’s proposal to impose a backstop (on how far back claims can go) will help mitigate the impact.

¹ This roughly includes 3.5m employees working full time and 1.2m employees working part time.

² Six year average, ASHE 2009-2014

³ There is a key assumption underpinning this analysis - there exists a proportional relationship between the proportion of employers that paid regular overtime (and include regular overtime in holiday pay) and the proportion of workers that get paid regular overtime (and include regular overtime in holiday pay).

ANNEX B - SURVEY RESULTS

BIS carried out a survey⁴ to complete 550 telephone-based interviews with businesses in the UK. All interviews were conducted with senior financial decision makers, and quotas are imposed by region, turnover, industry and number of employees. The data is weighted to be representative of all SME businesses in the UK with a turnover of £50,000+. To boost the sample of larger firms we increased the sample of 251+ employees from 50 to 100.

Size of Business	Sample size
1 employee (sole trader)	50
2-5 employees	75
6-10 employees	75
11-50 employees	150
51-250 employees	100
251+ employees	100
TOTAL	550

Quotas were also set by region and sectors to ensure some level of fair representation. Below is a summary of responses.

Do you pay any employees for overtime worked?

- Yes – 54%
- No – 46%

Do you pay any employees for REGULAR overtime worked? An employee would be considered to be doing “regular overtime” if he does extra hours (say 5 hours overtime) per week, consistently for one month.

- Yes – 55%
- No – 44%
- Don't know – 1%

And do you include or not include regular paid overtime when calculating pay for employees whilst they are on holiday?

- No, do not include the paid regular overtime - 44%
- Yes, include PART of the paid regular overtime - 8%
- Yes, include ALL of the paid regular overtime - 27%
- Not sure - 21%

For purposes of the analysis, we choose a range for of 55% to 70% for those paying regular overtime. This is because the survey results showed that larger employers are more likely to pay regular overtime and therefore the number of employees affected is likely to be higher than 55%. Of those who pay for overtime, 71% of firms employing 51 to 250 workers are likely to pay for regular overtime and 75% of firms employing over 250 workers are paying for regular overtime.

⁴ The survey was commissioned to BDRC continental

Survey Limitations

As a general caveat caution should be taken when making any inferences about the population based on the findings of this survey.

Specific issues include:

- Representativeness - There may be an element of voluntary response bias in the survey results. The sample may not therefore be representative in some or all respects of the whole population.
- Sample size – Several questions contain multiple options which results in some very small and nil responses. Caution should be taken when interpreting results of these questions.
- Self-reported data – the survey data is self-reported and no independent checks have been made on its accuracy. The result is that the data is only as reliable as the individual who completed it.

ANNEX C – RESULTS FOR OPTION 2A AND 2C

The table below present the main estimates and sensitivity analysis for option 2A and 2C.

Options	Liability on employers (savings from Do Nothing)
<i>Main cost estimates</i>	
Option 2A 3 Years backstop (10-35% take up) + transition (5% take up)	£280m – £560 Best estimate: £420m (5% transition; 22.5% backstop) Savings: £330m
Option 2C 1 Year backstop (10-35% take up) + transition (5% take up)	£210m – £320m Best estimate: £265m (5% transition; 22.5% backstop) Savings: £480m
<i>Sensitivity analysis – using mean wages</i>	
Option 2A 3 Years backstop (10-35% take up) + transition (5% take up)	£460m – £930m Best estimate: £690m (5% transition; 22.5% backstop) Savings: £540m
Option 2C 1 Year backstop (10-35% take up) + transition (5% take up)	£350m – £530m Best estimate: 440m (5% transition; 22.5% backstop) Savings: £800m
<i>Sensitivity analysis – increasing take-up rate for the transition period</i>	
Option 2A 3 Years transition (20% take up) +backstop (10-35% take up)	£760m – £990m Best estimate: £880m (20% transition; 22.5% backstop) Savings: -£130m
Option 2C 1 Year backstop transition (20% take up) + (10-35% take up)	£730m – £900m Best estimate: £820m (20% transition; 22.5% backstop) Savings: -£70m
<i>Sensitivity analysis – claims go back to six years under the do-nothing</i>	
Option 2A 3 Years backstop (10-35% take up) + transition (5% take up)	£210m – £490m Best estimate: £350m (5% transition; 22.5% backstop) Savings: £95m
Option 2C 1 Year backstop (10-35% take up) + transition (5% take up)	£140m – £ 250m Best estimate: £200m (5% transition; 22.5% backstop) Best estimate: £250m