Barnett Waddingham

Automatic Enrolment and Workplace Pension Reform

The Pensions Act 2008 laid the foundations for a fundamental change to workplace pensions in the UK. Under the reforms, every employer will be required to automatically enrol their eligible employees into a pension scheme and to pay contributions to that pension scheme.

Since the framework for these reforms was introduced, there have been extensive consultations with regards to their detailed implementation. Most recently, following the change in Government in 2010, an independent review was commissioned to consider whether the scope of the reforms struck the right balance between the costs and benefits to both employers and individuals. The review made a number of recommendations intended to reduce the burdens on business.

Following consideration of the review, the Department of Work and Pensions begun a consultation in July 2011 to put in place the legislation needed to complete these reforms. This consultation is intended to provide as much certainty as possible about the entire framework, and includes all of the draft regulations expected as well as explanations of what will be required.

In summary:

- Every employer must automatically enrol their employees (known as eligible jobholders) into a pension scheme if they are between age 22 and State Pension Age, earn more than a minimum threshold (£7,475 pa in 2011/2012) and work in the UK.
- The requirement to "auto-enrol" will be introduced over a period of four years starting in October 2012, depending on the size of the employer. The largest employers will be subject to the requirements first, followed by medium and then small employers.
- Any pension scheme used for auto-enrolment must meet minimum quality standards set by the Government. In particular, for "defined contribution" pension arrangements, employers are required to pay a minimum level of contribution for each employee.
- Employees who earn less than the minimum threshold for auto-enrolment and/or fall outside of the age range will be able to opt into a pension scheme if they wish. If they do so, their employer will have to pay minimum contributions on the same basis as if they were earning above the minimum threshold.
- Employees can opt out of the pension scheme if they wish. Employers are obliged to re-enrol eligible employees every three years, to give those who have opted-out the opportunity to reconsider their position.
- A new pension scheme, the National Employment Savings Trust ("NEST"), has been established. This pension scheme is available for any employer who chooses to use it, but is specifically designed for the needs of small employers who do not have any existing pension arrangements in which to enrol their employees.
- There are some limitations to NEST, including a cap on contributions (£4,200 pa in 2011/2012). Transfers, both in and out, will not normally be allowed. These restrictions will be re-considered in a further review planned for 2017.

The final proposals are under consultation and therefore some of the specific elements are subject to change. However, further explanation of the anticipated detail regarding the operation of auto-enrolment is set out in the table overleaf.

These reforms represent one of the most significant changes ever to have been made to workplace pension provision and there are a number of implications for employers and those involved with pensions to consider.

Identify your staging date

Employers should identify their "staging date" – i.e. the date on which they first become subject to auto-enrolment requirements. The staging date dictates when action is required; however, it might be worth considering bringing the staging date forward in some cases.

Consider which pension scheme to use for auto-enrolment purposes

Employers should consider which pension scheme(s) they intend to use for auto-enrolment and check whether it meets the minimum quality requirements for this purpose. If not, amendments will need to be considered well in advance to ensure the pension scheme is ready by the staging date.

If you are currently making changes to your pension arrangements, for example closing a defined benefit scheme and replacing this with a hybrid or defined contribution arrangement, then you should consider auto-enrolment requirements when designing the new arrangement.

Setting up a new pension arrangement

Ten million individuals are expected to be eligible for auto-enrolment, so pension providers and administrators will be processing an unprecedented number of new members. To ensure that the introduction of the auto-enrolment process works smoothly, the chosen provider should be approached in plenty of time to ensure the arrangements are ready by the staging date.

Mitigating cost increases

Some employers will already have pension schemes that meet minimum quality requirements, but due to the level of required employee contributions they have a relatively low take-up rate. Following auto-enrolment, employees will need to make an active decision to opt-out, and many pension schemes are likely to see significant increases in take-up rates as a result.

Other employers will have pension schemes that already meet the minimum quality requirements, but only for certain categories of employee. Following auto-enrolment, all categories of employee must be provided with pension benefits that meet the minimum quality tests.

Under both of these scenarios, pension costs could significantly increase. Employers should understand any potential increase in costs and consider taking mitigating action, for example redesigning aspects of the pension scheme or renumeration strategy to achieve a lower overall cost per pension scheme member.

Employers can use several pension arrangements for auto-enrolment purposes if they wish. For example, an employer may wish to have different benefit tiers in their main defined benefit or defined contribution arrangement for different levels of permanent staff, and then use a defined contribution plan or NEST to facilitate minimum contributions for staff on short-term or flexible working contracts.

Auto-enrolment and corporate transactions

If you are considering purchasing another company, auto-enrolment should be taken into account when assessing the potential pension costs associated with that company. Auto-enrolment will significantly increase pension costs for some companies, which in turn could have an impact on profitability.

Payroll and HR processes

Employers should ensure that their payroll systems, employee communications and other HR processes are ready for auto-enrolment well in advance of their staging date.

Further information

If you require assistance with any of the issues set out above, please contact your usual Barnett Waddingham consultant or email autoenrol@barnett-waddingham.co.uk

Further detail in relation to the auto-enrolment regime

Overview

What is auto-enrolment?

Under reforms originally introduced in the Pensions Act 2008, every employer will be required to automatically enrol eligible employees into a pension scheme and to pay contributions to that pension scheme.

Why is the Government introducing these reforms?

Automatic enrolment was one of the key recommendations of the independent Pensions Commission, which reported in October 2004 and November 2005, in response to findings that people are living longer and not saving enough to provide an adequate income in retirement.

Which employees will need to be auto-enrolled?

Employees will need to be auto-enrolled if they:

- are not already in a "Qualifying Workplace Pension Scheme" (i.e. a pension scheme providing minimum retirement benefits)
- are at least 22 years of age
- have not reached State Pension Age
- earn more than the minimum earnings threshold (currently £7,475 pa in 2011/2012), and
- work or ordinarily work in the UK.

What is the minimum level of contribution?

In very broad terms, the minimum total contribution will be 8% of "qualifying earnings". Of this, employers must pay at least 3% of qualifying earnings. However, this is being phased in over time and is subject to a number of considerations which are set out in more detail below.

When are the reforms being introduced?

The reforms are being introduced over a four year period beginning in October 2012. The largest employers will be subject to the requirements first, followed by medium and then small employers.

Timing

How do I know when I am affected?

Each employer has a date on which they have to begin the process of auto-enrolment. This is referred to as their "staging date".

How is the staging date determined?

The staging date is determined based on an employer's PAYE scheme. For example:

- The largest employers (more than 120,000 employees in their PAYE scheme) will have a staging date of 1 October 2012.
- The smallest employers (fewer than 50 employees) will have a staging date between 1 March 2014 and 1 February 2016 depending on their PAYE reference number.
- Other employers will have a staging date between 1 October 2012 and 1 July 2014 depending on the exact number of employees in the PAYE scheme.
- New employers from 2012 onwards will have a staging date during 2016, depending on when they first have employees in their PAYE scheme.

Full details of staging dates are set out on the DWP website: www.dwp.gov.uk/docs/staging-dates-by-employer.pdf.

How can I be certain when my staging date is?

The Pensions Regulator will write to all employers twelve months before their staging date so that they know exactly when they will be subject to the auto-enrolment requirements, and will remind employers again three months before their staging date.

What if I have more than one payroll?

Generally employers with more than one PAYE will start their duties for all their PAYEs at the same time, based on the staging date of their largest PAYE.

Can I decide to start auto-enrolling before my staging date?

Yes. Some employers may wish to align their staging date with another key date in their operational calendar, say the start of their financial year. Larger employers (i.e. those with over 50,000 employees) can choose to start auto-enrolling employees from 1 July 2012. Other employers can begin auto-enrolling employees from 1 October 2012, subject to restrictions prescribed by the Pensions Regulator. Employers wishing to make use of early auto-enrolment must notify the Pensions Regulator at least one month before their proposed new staging date.

Further detail in relation to the auto-enrolment regime

Minimum contribution requirements

How are the minimum pension contributions being introduced?

To ease the burden on employers and individuals who have not previously paid pension contributions, the minimum contribution of 8% of qualifying earnings is being introduced in stages as set out in the following table:

Period	Minimum total contribution
1 October 2012 to 30 September 2016	2%
1 October 2016 to 30 September 2017	5%
1 October 2017 onwards	8%

How much of this must the employer pay?

The minimum employer contribution is also being introduced in stages:

Period	Minimum employer contribution
1 October 2012 to 30 September 2016	1%
1 October 2016 to 30 September 2017	2%
1 October 2017 onwards	3%

How are qualifying earnings determined?

Qualifying earnings are based on an employee's total earnings (i.e. salary, overtime, bonus payments etc) over a minimum level and up to a maximum level.

What are the minimum and maximum level of qualifying earnings?

The minimum is £5,035 pa and the maximum is £33,540 pa in 2006/2007 terms. The final earnings thresholds will be confirmed in January 2012 and thereafter reviewed each year and increased broadly in line with other thresholds used for tax and National Insurance purposes.

Over what period are qualifying earnings measured?

Earnings are compared against the thresholds based on when the earnings are paid, in accordance with an employer's normal pay period. So, for example, where earnings are paid on a monthly basis, they are compared with the equivalent monthly thresholds, £420 and £2,795 respectively in 2006/2007 terms.

Can the employer and employee pay more if they wish?

Yes, the contributions above are only the minimum contributions. Both the employer and the individual can pay more than this, if they wish. If the employer pays more, the contributions payable by the individual can be lower as long as the total contribution is at least equal to the minimum.

Choosing a pension scheme for auto-enrolment

Can I use my existing pension scheme for auto-enrolment?

Yes, as long as it meets certain qualifying standards.

My existing pension scheme has contribution rates that are higher than the maximum, but the earnings definition is different. Do I need to check the minimum contribution for every employee?

Not necessarily. Many employers will have pension arrangements with different definitions of pensionable pay, i.e. the earnings on which contributions are based. For example, it is common for pensionable pay to be based on basic salary only. The Government recognises this and proposes to introduce a straightforward test for pension schemes to demonstrate minimum quality requirements.

Choosing a pension scheme for auto-enrolment continued

What is the test to demonstrate minimum quality requirements?

A pension scheme is deemed to meet the minimum requirements if, based on the documentation governing the scheme, any of the following applies:

Tier	Definition of pensionable pay	Minimum employer contribution	Minimum total contribution
1	Basic pay	4%	9%
2	Pensionable pay at least 85% of total pay	3%	8%
3	Total pay	3%	7%

Is there any phasing in relation to these tests?

Yes. The required level of contribution in the three tests above is being phased in over a five year period in a similar way to the minimum required contribution:

Period	Tier 1 minimum Employer/Total	Tiers 2&3 minimum Employer/Total
1 Oct 2012 to 30 Sep 2016	2%/3%	1%/2%
1 Oct 2016 to 30 Sep 2017	3%/6%	2%/5%
1 Oct 2017 onwards	As detailed in the previous answer	

How do I confirm that my pension scheme meets these requirements?

The employer is responsible for certifying that the pension scheme meets one of these tests. The calculations can be carried out by a payroll department or third party administrator, but only an appropriately authorised individual can sign the certificate e.g. a director of a limited company or the senior partner of a partnership.

How long does the certificate last?

The certificate must be renewed every 12 months.

What about "defined benefit" schemes?

Alternative arrangements apply to certifying minimum quality requirements for pension schemes where some or all the pension is based on a formula rather than the value of the contributions paid.

What are the alternative arrangements for defined benefit schemes?

A defined benefit scheme that is "contracted-out" of the state second pension is automatically deemed to meet the minimum requirements.

A defined benefit scheme that is not "contracted-out" is deemed to meet the minimum requirements if it meets the "test scheme standard".

What is the "test scheme standard"?

The test scheme is a benchmark to which a pension scheme is compared. To meet the minimum requirements, a pension scheme must provide benefits that are broadly equivalent to or better than the test scheme. It does not need to match the structure of the test scheme exactly.

What are the benefits provided by the test scheme?

Broadly speaking, the test scheme consists of the following:

- An annual pension of 1/120th of earnings for each year of service payable from age 65, gradually increasing to age 68 (to reflect increases in state pension age).
- Increases to pensions in payment in accordance with Consumer Price Inflation, with a maximum increase of either 5% pa or 2.5% pa depending on when the pension was earned.

Who certifies that the scheme meets the test scheme standard?

Usually the actuary to a defined benefit scheme will perform the necessary calculations, although in some circumstances the employer may certify the scheme if it is clear it meets the test scheme standard in all circumstances and no actuarial calculations are required.

Further detail in relation to the auto-enrolment regime

Choosing a pension scheme for auto-enrolment continued

When is this certification needed?	Under transitional provisions, defined benefit pension schemes have until 1 October 2016 to certify that they meet these requirements for existing active members. However, defined benefit schemes that are open to new employees will need to be certified ready for auto-enrolment on the employer's staging date.
What about "hybrid schemes", that provide part defined benefit and defined contribution?	A hybrid scheme that provides both defined benefit and defined contribution elements of a pension will need to meet a combination of the requirements for each of these arrangements depending on the precise nature of the benefits.
I don't have a pension scheme that meets any of the above criteria. What are my options?	You could set up a new pension scheme or amend an existing pension scheme to meet the minimum quality criteria. Alternatively, you could use the National Employment Savings Trust ("NEST").

National Employment Saving Trust (NEST)

What is NEST?	NEST is a pension scheme that is open to all employers, but has been specifically designed for the needs of small employers who do not have any existing pension arrangements. It aims to offer a simple, low cost pension solution for employers and individuals.
Are there any restrictions on NEST?	Contributions will be subject to a maximum (£4,200 pa in 2011/2012) and transfers in and out will not normally be permitted. Members' investment choice will also be restricted to a small range of funds. The Government will review these restrictions in 2017.
Is NEST suitable for everyone?	No. The simple low cost approach and limited investment choice will not appeal for those seeking greater flexibility from their pension arrangements, and the cap on contributions makes it unsuitable for individuals with earnings above a certain level.
Can I use more than one pension scheme for auto-enrolment?	Yes. An employer can use different pension schemes for different parts of their workforce, as long as every eligible employee is auto-enrolled in a scheme receiving minimum contributions or satisfying minimum quality requirements.

The auto-enrolment process

Which employees must be automatically enrolled?	Any employee who is aged between 22 and State Pension Age and has earnings which exceed the earnings trigger. The earnings trigger is £7,475 pa in 2011/2012 and is intended to increase in line with other thresholds used for tax and National Insurance purposes.
Over what period are earnings compared against the earnings trigger?	Earnings are compared against the trigger based on when the earnings are paid, in accordance with an employer's normal pay period. So, for example, where earnings are paid on a monthly basis, they are compared with the equivalent monthly trigger, currently £622.92.
From when must an employee be enrolled from?	All employees that meet the criteria must be auto-enrolled on the employer's staging date. Thereafter, each employee must be auto-enrolled with effect from the date they meet the criteria (i.e. reach age 22 or have earnings exceeding the earnings trigger).
Is there any option to postpone auto-enrolment?	All employers are allowed to defer an individual's auto-enrolment date by up to three months. This waiting period is intended to provide an administrative easement with respect to short-term workers. However, individuals in a waiting period have a right to "opt in" if they wish, and minimum contributions must then be paid with effect from the next pay period.

The auto-enrolment process continued

What about employees who are not eligible for auto-enrolment?	Individuals aged between 16 and 75 who are not eligible for auto-enrolment can choose to "opt in" if they wish. Where such individuals earn more than the lower earnings threshold (£5,035 pa in 2006/2007 terms), minimum contributions must be paid as described above.
Can an individual choose to opt out of auto-enrolment?	Yes. An individual can opt out if they want to, but can only do so after being auto-enrolled. They have one month from the date they became a member to opt out and any payments made to the pension scheme on their behalf will be refunded. Employers must not incentivise opt-outs.
Can an individual who has not opted-out of auto-enrolment leave the pension scheme at a later date?	Yes. An individual can choose to leave the pension scheme at any time. However, once the one month period has expired any pension contributions paid on their behalf to a "contract-based" arrangement cannot be refunded and must remain in their pension pot. Contributions made to an "occupational" arrangement would be subject to the scheme rules.
Can an individual who has opted-out or left the pension scheme re-join?	Yes. An individual who has previously opted-out or left the pension scheme can re-join at a later date, and minimum contributions must then be paid as described above.
Do employers have any further responsibilities for employees that have opted-out?	Yes. An employer must automatically re-enrol individuals that have previously opted-out or left the pension scheme, generally on every third anniversary of their staging date. This is to give those that have left the pension scheme an opportunity to reconsider their position.
What information do I need to provide to employees about the auto-enrolment process?	Employers must provide the following information. • Employees eligible for auto-enrolment must be provided with information relating to the pension scheme in which they are being enrolled within one month of their auto-enrolment date. • Employees aged between 16 and 75 not eligible for auto-enrolment must be provided with information about their right to opt in within one month of becoming eligible. • Employees who are already a member of a pension scheme meeting minimum quality requirements must be provided with information relating to that pension scheme within two months of their auto-enrolment date. • Employers deciding to use a waiting period must give notice of this to their employees, either individually or on a generic basis depending on the circumstances.

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Further detail in relation to the auto-enrolment regime

Employer compliance

Who monitors compliance with the auto-enrolment regime?	The Pensions Regulator, which is the Government body responsible for the regulation of UK workplace pension schemes.
How does the Pensions Regulator know I have fulfilled my auto-enrolment responsibilities?	When an employer has completed the auto-enrolment process, they must register with the Pensions Regulator. This demonstrates that they have met their auto-enrolment responsibilities. It will also help the Pensions Regulator to identify employers who might need further support to comply with auto-enrolment requirements.
What happens if I do not comply with auto-enrolment requirements?	The Pensions Regulator may issue a fixed penalty notice of £400 against any employer who has contravened regulations or failed to do what is required of them. The fixed penalty notice may warn that escalating penalties could become due if non-compliance continues.
What are escalating penalty notices?	Where an employer remains non-compliant despite having received warnings the Pensions Regulator may issue an escalating penalty notice requiring them to pay a daily penalty until they become compliant. The amount of the penalty depends on the size of the employer, but could be as much as £10,000 per day for the largest employers.

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