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Update on Auto Enrolment and the new NEST Scheme

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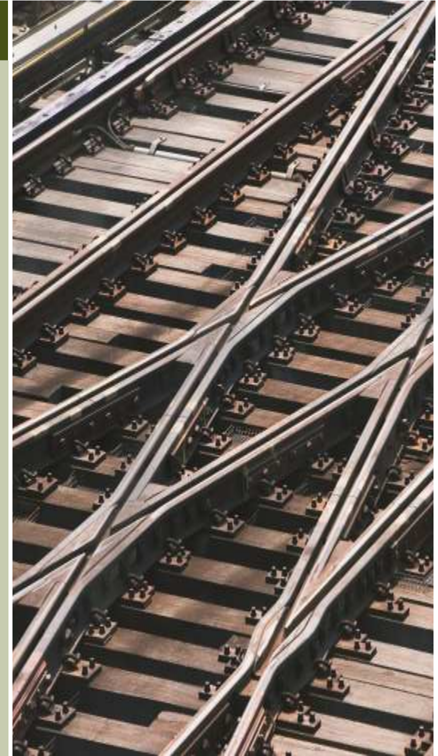
Pensions Briefing

HIGHLIGHTS

Large employers are required to begin automatically enrolling workers into qualifying pension schemes from October 2012, and all employers employing more than 50 employees will be subject to the new regime by January 2014. Under the auto-enrolment regime:

- All employers will be obliged to enrol "jobholders" who earn more than £7,475 pa and are aged 22 to state pension age, automatically in a pension scheme meeting the "quality requirements".
- Employers will also need to enrol those who do not qualify for auto-enrolment into a pension scheme if they so request.
- For the first 5 years, participation will be phased in according to the size of the employer, only minimal contributions will be required, and a transitional period will apply for employees who are eligible to participate in qualifying defined benefit schemes.
- From October 2017, employers using a DC scheme for auto-enrolment must ensure that contributions equalling 8% of qualifying earnings are paid into the scheme for each qualifying jobholder (with 3% coming from the employer). Alternatively, an employer may certify that minimum levels of contributions are being paid, calculated by reference to the scheme's definition of pensionable pay.
- An eligible jobholder must be auto-enrolled within three months of the date on which he or she first meets the age and income requirements. Notice requirements apply immediately, however.



KEY PHRASES

- "earnings trigger" is the annual income that a jobholder must be earning in order to be eligible for automatic enrolment. It is currently set at the income tax threshold, £7,475 pa.
- "jobholder" is a worker aged 16 - 75 ordinarily employed in Great Britain who earns qualifying earnings in a pay reference period. Jobholders between the ages of 22 and state pension age are "eligible jobholders" who must be auto-enrolled if their earnings are equal to, or exceed, the earnings trigger.
- "pay reference period"
  - for the purpose of determining whether a jobholder has qualifying earnings, is based on the worker's pay cycle (eg weekly, bimonthly or monthly pay periods); and
  - when determining whether there has been sufficient pension accrual in relation to qualifying earnings, is one year.
- "qualifying earnings" are earnings, including bonuses and overtime, equivalent to £5,035 - £33,540 annually, pro-rated over a pay reference period. "Qualifying earnings" are likely to differ from "pensionable pay" under most schemes.
- "worker" is an individual, including an individual who is self-employed under the tax laws, who "undertakes to do work or perform services personally" except as a "profession or business undertaking".

AUTO-ENROLMENT - THE BASICS

Who will be affected?

Every UK employer, no matter what size, and any individuals working for them either as employees or under a contract of services will be affected by the new requirements.

Employers must automatically enrol "jobholders" (see box) who are aged 22 to state pension age and have earnings of at least the level of the "earnings trigger" (currently £7,475 on an annual basis) into a scheme meeting certain minimum quality requirements (see below). Other workers must be given an opportunity to opt in.

Each employer has been given a "staging date" based on PAYE size. The largest employers must begin auto-enrolment no later than October 2012.

What is automatic enrolment?

Automatic enrolment, or auto-enrolment, is the process under which an employer arranges for an eligible jobholder to be automatically enrolled in a pension scheme that meets the minimum quality requirements.

How does auto-enrolment work?

Basically:

- The employer must auto-enrol each eligible jobholder retrospectively to the "auto-enrolment date" within one month of that date.
- The auto-enrolment date is normally the staging date or the beginning of the first pay period after which the jobholder becomes eligible, but may be deferred by the employer for up to three months provided that the jobholder:

  - is informed of the later "deferral date" and
  - is given opportunity to opt in prior to the deferral date.
- Each jobholder must be informed of the opt out period. The opt out period is a period of one month beginning on the later of:
  - the date on which the jobholder "achieves membership" in the pension scheme (which membership must be made retrospective to the auto-enrolment date) or
  - the date on which the jobholder receives information about the scheme from the employer or the employer's agent (eg the scheme administrator, the employer's consultant, etc)
- In the meantime, the employer must deduct the eligible jobholder's contribution from his first pay packet after the auto-enrolment date (or the deferral date if this option is taken). The contribution need not be submitted to the scheme until after the end of the second month following withholding it. This is to reduce situations in which the scheme must make refunds.
- If the jobholder opts out during the opt out period, he or she must be treated as though he or she had never been a member.
- If the jobholder does not opt out, he or she must remain an active member of a qualifying scheme unless he or she chooses to leave active membership.
- Eligible jobholders who are already active members of a qualifying scheme simply need to be sent information about the scheme and the relevant law within two months of what would have been their automatic enrolment date.

What is automatic re-enrolment?

Each employer must conduct a re-enrolment exercise every three years in which it automatically enrols all of its eligible jobholders who are not enrolled. (Those who have opted out within the past 12 months may be excluded.)

Do I need to auto-enrol all employees?

Only eligible jobholders (that is, those age 22 - state pension age who meet the earnings trigger) must be auto-enrolled. However information about the scheme must be distributed to non-eligible jobholders as well and:

- A jobholder who does not qualify because he is over state pension age or under age 22 may opt in to a qualifying scheme, and the employer must pay the minimum contribution.
- A jobholder earning less than the earnings trigger but more than the qualifying earnings threshold may opt in to a qualifying scheme and the employer must pay the minimum employer contribution.
- A worker whose earnings are too low to be qualifying earnings may choose to enrol in a registered pension scheme, which must be furnished by the employer. No employer contribution, or minimum employee contribution, is required.

Compliance

The Pensions Regulator (tPR) is charged with monitoring compliance and enforcing the provisions. Each employer is required to register with tPR and provide certain information. The intention is that this information may be readily compared against HMRC records, enabling tPR to identify employers who are failing to comply.

tPR stresses that it will consider its role in the first years as educational and that enforcement will be graduated. tPR will begin by informing employers that they have not fulfilled their obligations, and then move to issuing compliance or unpaid contribution notices. However, the potential penalties are significant and could reach £10,000 a day for larger employers

Notice to workers

The auto-enrolment regime includes requirements to notify eligible and non-eligible workers of their rights within tight timeframes.

Record-keeping and provision of information

Employers must keep records of each jobholder's auto-enrolment date and, where applicable, his or her opt out notice, along with information concerning earnings and contributions. Trustees and providers must keep records of the dates on which jobholders achieve and leave active membership (including records concerning members who have opted out), as well as personal data such as name, National Insurance number and residential address, even where the member opts out.

Prohibited recruitment conduct and inducement

Employers are prohibited from engaging in conduct that encourages opting out.

"Prohibited recruitment conduct" consists of statements or questions that indicate that an applicant's job prospects may be conditional on opting out. Similarly, once a jobholder is in employment, an employer may not take an action "for the sole or main purpose" of inducing that member to opt out or end active participation in the pension scheme. There is some uncertainty around what constitutes an “inducement” and the circumstances in which the terms of a flexible benefits plan could be considered inducement.

When do employers need to think about auto-enrolment?

Now. The legislation has not yet been finalised but no further substantial changes are expected.

It is worth noting that the obligations will be phased in gradually. So, where the employer will auto-enrol jobholders into a DC scheme:

- the minimum contribution during the initial phasing period (2012 - 2016) will be 2% of qualifying earnings, with a 1% minimum employer contribution; and
- in 2016 the rate will rise to 5% in total, with a 2% minimum employer contribution.

By 1 October 2017, all employers should be auto-enrolling eligible jobholders into a fully qualifying scheme.

What should employers be thinking about?

You will need to consider:

- whether there is currently a scheme in place that is or can be made a qualifying scheme;
- whether there are changes to the benefit structure or default option that will need to be made in order to make your scheme a qualifying scheme;
- whether an alternative scheme, including the NEST scheme (see box), is a better option for all or some of your employees;
- which individuals performing services will be eligible jobholders (this may include some who are self-employed for tax purposes);

- how you will deal with workers whose earnings fluctuate;
- what communications will be required in advance of your staging date;
- whether changes need to be made in your scheme rules regarding eligibility and waiting periods in order to accommodate auto-enrolment;
- how the auto-enrolment requirements will fit into such employment arrangements as salary sacrifice and flexible benefit offerings;
- what systems adjustments will be required to allow for the collection of contributions, and for their return where the jobholder has opted out; and
- how compliance with the notice, record-keeping and timing requirements under the new regime will be managed.

THE NEST SCHEME

To aid employers who might otherwise have difficulty establishing or finding an appropriate qualifying scheme into which to auto-enrol workers, the Government has established the National Employment Savings Trust (NEST).

NEST is a DC arrangement targeted at lower-income members, and is intended to be low-cost. There will be a contribution limit, currently set at £3,600 per annum. It will not make transfers to other pension schemes except after age 55, on incapacity or as a result of a pension sharing order. At present, it is not allowed to accept transfers under the statute, although this is currently under review and will definitely be subject to reconsideration in 2017.

It is intended that a member will have one NEST account over his or her lifetime, to which successive employers may contribute. In order to keep administrative costs as low as possible, much of the administration and communication will be conducted on-line.

DOES MY SCHEME MEET THE QUALITY REQUIREMENTS?

Both occupational and personal pension schemes may be used for auto-enrolment. The requirements differ depending on the type of scheme being offered.

DC scheme

The default statutory requirements for DC schemes are a minimum contribution of 8% of qualifying earnings with at least 3% contributed by the employer.

However, where an employer's contributions are calculated by reference to pensionable pay (as opposed to qualifying earnings), an employer may self-certify its scheme (for some or all jobholders) if it can show that total contributions over a one year period are at least:

- 9% of pensionable pay, with an employer contribution of 4%; or
- 8% of pensionable pay, with a 3% employer contribution, where pensionable pay constitutes at least 85% of the total pay bill; or
- 7% of pensionable pay, with a 3% employer contribution, where 100% of the total pay bill is pensionable.

"Pensionable pay" in each case must be at least equal to basic pay, counted from the first pound sterling paid. (Self-certification regulations are still in draft and subject to consultation but are not expected to change substantially).

A DC scheme must have a default investment into which a member may be enrolled without making any choice. The DWP has published guidance setting out its expectations regarding the governance and design of the default option (http://www.dwp.gov.uk/docs/def-opt-guid.pdf).

Traditional final salary defined benefit scheme

If the scheme is contracted-out of the state second pension on the reference scheme basis it will automatically meet the minimum requirements.

A non contracted-out scheme must show that it provides benefits broadly equivalent to the "test scheme" requirements.

The "test scheme requirements" are that 90% of relevant members must be provided with benefits of equal value to a DB scheme:

- in which the accrual rate for each year of pensionable service is 1/120th of average qualifying earnings in the last three years of pensionable service;
- with a normal retirement date of 65 (possibly gradually rising to age 68 in 2044);
- that "inflation proofs" deferred pensions and pensions in payment in accordance with current requirements for DB schemes.

Career average scheme

A qualifying career average scheme is one which provides benefits at least equivalent to 1/120th of average qualifying earnings in the last three years of pensionable service at age 65 and which provides for revaluation of the benefits in deferment at the lower of the increase in inflation (on an RPI or CPI basis) for that year or 2.5%. Revaluation may be discretionary so long as the statement of funding principles or its equivalent assumes revaluation at no less than the minimum rate.

Cash balance scheme

A cash balance scheme may be a qualifying scheme where the lump sum amount available at retirement for purchase of an annuity is, for each year of pensionable service, equal to at least either:

- 16% of average qualifying earnings in the last three years of pensionable service; or
- 8% of average qualifying earnings in the last three years of pensionable service, increased each year by the aggregate of 3.5% and the lower of the increase in inflation for that year or 2.5%. (At present the regulations refer to RPI in the inflation requirement, but we understand that this will be changed to CPI.)

Hybrid scheme

Where DB and DC benefits are earned simultaneously, the DB and DC benefits are tested separately, and

- if either the DB or the DC benefits meet the relevant DB or DC qualifying scheme test, the scheme is a qualifying scheme;
- if neither the DB nor the DC benefits alone would meet the qualifying scheme test, each set of benefits is measured against the relevant test, expressed as a percentage of the benefits expected under that test. If the percentages added together total at least 100% in respect of at least 90% of the members, the scheme is a qualifying scheme.

WHERE CAN I GET MORE INFORMATION?

The Pensions Regulator has published a series of useful guidance regarding employer duties and automatic enrolment that is available at *http://www.thepensionsregulator.gov.uk/pensions-reform/detailed-guidance.aspx.*

The Department for Work and Pensions has published guidance for certification of money purchase schemes at *http://www.dwp.gov.uk/docs/money-purchase-schemes-guidance.pdf*

This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

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