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Auto-Enrolment and NEST

Introduction

Employers will soon be subject to a new duty to enrol eligible employees automatically into a pension scheme and pay a minimum level of contributions in respect of those who are enrolled.

A lot of the detail in relation to these new pensions 'auto-enrolment' obligations is still outstanding and may be subject to further change. However, some aspects of the new regime are becoming clearer, and many clients are starting to think about how they can prepare for compliance.

When will the duty start to apply?

This will start from October 2012 for very large employers. Its implementation is then staggered, for decreasing sized employers (based on the number of people they employ) through to September 2016 (although an employer can voluntarily comply with the new requirements early if it chooses). For example, an employer with between 350 and 499 employees will have to comply with the new duties from 1st January 2014.

The Pensions Regulator will write to all employers 12 months before the new duties are due to apply to them, but a table showing how this is staggered can be found at: http://www.dwp.gov.uk/docs/auto-enrol-and-wpr-the-facts.pdf.

What is the basic auto enrolment duty?

In summary, based on the legislation and draft legislation currently available, an employee will be a 'jobholder' who must be auto-enrolled if:

- they work under a contract of employment in Great Britain;
- they earn over £7,475 per annum (although it is possible for lower earners to opt in);
- they are aged 22 or over, but under state pension age (although some employees under 22 can also choose to opt in); and
- have completed a three month waiting period, if the employer chooses to impose one.

A jobholder must be enrolled either into their employer's own 'qualifying scheme' or into the Government's new national employment savings trust, "NEST" (which has been established as a money purchase pension scheme).

It will be possible for a jobholder to opt out of a pension scheme but, as the legislation currently stands, only once they have already been auto-enrolled. They must then be allowed to opt in once a year, and be auto-enrolled again every three years.

What contributions will be made?

If a jobholder is enrolled in NEST:

- the jobholder must contribute 4% of his earnings into NEST;
- his employer must contribute 3% of his earnings into NEST; and
- a further 1% contribution will be made up of tax relief.

However, these levels of contribution will be phased in over a five year period. For example, for the first four years of the new obligation applying to an employer, contributions of 1% of earnings will need to be made by each of the employer and the jobholder.

Can I use my existing pension scheme to meet my auto-enrolment obligation?

There are a number of qualifications that an existing pension scheme must meet to be able to be used to satisfy the auto-enrolment obligations, and some of these are still in draft legislation or yet to be finalised.

However, broadly speaking, an employer's own scheme can be a qualifying scheme if it meets the following standard:

- defined contribution schemes (including occupational DC schemes or group personal/stakeholder pension schemes): these must provide for at least the level of contributions set out above in relation to NEST. These types of schemes will be able to 'self certify' as compliant schemes.
- defined benefit schemes: these must meet the test scheme standard which, in summary, means they must have a normal retirement date of 65, provide accrual at a rate of 1/120th of average earnings in last three years multiplied by service to a maximum of 40 years and provide revaluation and increases in line with statutory minimum. The employer and actuary must also certify that they are compliant schemes.

What should we be doing to prepare for auto-enrolment?

Employers need to recognise that the new obligations will soon apply to them, and work out when they will first be affected. They will also need to start to make plans for complying with the new duties, and decide which vehicle they will use to do that.

Although the new duties will predominantly apply to employers, the Pensions Regulator points out that trustees also have a role to play. At this stage, the key points are that trustees should:

- find out when the employer will become subject to the new auto-enrolment requirements;
- discuss auto-enrolment with the scheme's sponsoring employer to determine if their pension scheme can or will be used to meet the automatic enrolment requirements; and
- respond to any requests from the employer with regards to their pension scheme meeting the requirements for existing active members.

Depending on whether an existing pension scheme will be used by the employer in the auto-enrolment regime and how, the follow up actions for trustees could be minimal or quite significant.

Age Discrimination – Default Retirement Age Abolished

Since age discrimination legislation came into force on 1st December 2006, employers who sponsor pension schemes with normal retirement ages below 65 have had to allow some form of pension accrual to continue for members who keep working beyond their pension scheme's normal retirement age. The fact that employers could cease an employee's service at the default retirement age of 65 meant that employers had some control over the longstop date for such benefit provision should they wish to cease it.

However, the ability for employers to be able to give an employee notice to retire at age 65 (based purely on the fact that the employee has reached that age) was removed earlier this year.

As that long stop no longer exists, this will naturally mean that more employees will take 'late retirement' and employees will need to be allowed to continue pension accrual in some form until employment ceases.

In terms of what pension benefits those members should be offered, there has been a lot of speculation by commentators. The question applies both in terms of the treatment of their benefits accrued before their normal retirement date (for example, in a defined benefit scheme, through continued final salary linkage, application of a late retirement factor, or the greater of either of these) and in terms of continued benefit accrual after normal retirement date (by continued accrual in the same scheme, or through providing accrual in another scheme after normal retirement date). There is no clear cut answer and employers and trustees need to continue to consider the options and test whether the preferred ways of dealing with this issue represent a reasonable response to the legislative requirements.

'Insurance' related benefits

One area that has been brought into focus by the removal of the default retirement age is the issue of the continued provision of insured benefits. This has been a key area for employers as the increased risk of insurers having to pay out for older workers (through a higher chance of, for example, death or ill health) means that insurance for those older workers can be more expensive.

To deal with this, the Government introduced an exemption to the abolition of the default retirement age meaning that *employers* can stop the provision of insurance at age 65 (or at state pension age when this becomes higher than 65). However, this exemption has been narrowly drafted. This means that it has been widely interpreted as not being flexible enough to allow pension schemes to stop providing insurance type benefits (such as death in service lump sum cover) at age 65, even if the Government had intended this to be allowed.

Bribery Act 2010

Although not directed at trustees of pension schemes, the Bribery Act 2010 does create offences which could be relevant to trustees.

The basic offences

For both individual trustees and for corporate trustees, the two offences that could apply are that of giving a bribe or receiving a bribe. The former is unlikely to be relevant, but trustees are recommended to consider whether any steps need to be taken to avoid the offence of receiving a bribe. This would not need to be significant action, but it may be sensible to minute considering this at an upcoming meeting, or adding a line to an existing risk register or conflicts policy.

Corporate offence applying to corporate trustees?

Corporate trustees may have to consider the further offence of failing to prevent bribery. This offence is committed if a service provider, whilst performing services for the corporate trustee, bribes another person to obtain or retain either business or a business advantage for the corporate trustee.

There is some uncertainty as to whether this further offence is relevant to corporate trustees of pension schemes as the corporate trustee has to undertake 'commercial activity' to be caught. However, professional trustee companies are likely to be caught, and many commentators are taking the approach of recommending action be taken by all corporate trustees to minimise any risk.

The main way of doing this is to take action to put in place 'adequate procedures' to prevent bribery, as this is a defence to the charge. Although many corporate trustees will take the view that committing this offence is unlikely anyway, it may nevertheless be worth them considering addressing this issue with their providers by, for example, asking for a copy of their anti-bribery policy or details of measures taken by them to prevent bribery.

Early Access Off the Table

The Government has signalled that it is no longer considering allowing early access to pension savings (through, for example, an ability to make withdrawals from an age below 55 in hardship cases as is allowed in the U.S. and Australia).

The Government's argument for not allowing early access when other countries do is that it is more logical to allow early access in those countries where auto-enrolment already takes place. The concession therefore for auto-enrolling people in pension schemes is that they can then draw some of those benefits early in extreme circumstances.

On that basis, the Government have said that they may revisit this once the new auto-enrolment duties (see main item above) are fully in place.

DC Contracting Out

DC contracting-out certificates will be cancelled with effect on and from 6th April 2012 and members will be automatically contracted in to S2P from that date. At the same time, existing restrictions (for example, compulsory provision of survivor's benefits) will no longer apply to rights already accrued.

This has prompted fears that transfers of contracted-out final salary benefits into non-contracted out (i.e. all) money purchase schemes would no longer be possible. However, legislation has now been published which specifically allows such transfers to be made after 6th April 2012, and these may become more popular given new income drawdown provisions.

One of the key aspects of this change is that trustees must inform their members of the abolition of DC contracting-out and its consequences either in the 12 months before 6 April 2012 or as soon as practicable thereafter.

Identifying Your Employer

The Pensions Regulator is urging trustees to ensure that they are properly identifying the statutory employer(s) of their schemes, and to assess the support that comes from different employers associated with the scheme. This is clearly important when assessing covenant strength to ensure that the right entity/entities are under the spotlight.

The Pensions Regulator also emphasises that it may often be the case that entities other than the statutory employer are the ones who provide the key financial support to pension schemes. However, it is nevertheless the statutory employer(s) who will be the employer(s) legally responsible for:

- meeting the scheme funding objective of the pension scheme;
- paying the section 75 debt when an employment cessation event occurs on employer departure from a multi-employer scheme, on scheme wind-up or on employer insolvency; and
- triggering entry to a Pension Protection Fund (PPF) assessment period on insolvency.

From November 2011, trustees will therefore be asked to identify their statutory employer(s) to the Pensions Regulator on their scheme returns.

IAS19 Changes

For accounting periods ending after 1st January 2013, a new version of IAS19 looks set to apply which will require sponsoring employers to be more transparent about the impact of their pension obligations in their company accounts.

The main change is that employers will be required to calculate the expected return on scheme assets by reference to the return on AA corporate bonds, instead of actual scheme assets. It has recently been suggested that this could reduce the reported profits of UK companies by an estimated £10billion.

Legislation – Finance Act 2011/Pensions Bill 2011

The Finance Act 2011 received Royal Assent last month. This Act finally introduces the detail of many of the tax changes that have been anticipated for pension schemes. The Act mainly covers the lower annual allowance with associated changes (e.g. "scheme pays" provisions) and changes in relation to compulsory annuitisation at age 75. As these measures are now finalised, members and pension schemes can now properly assess the impact of these on their benefits.

The Pensions Bill is also reaching the final stages of the Parliamentary process, and should receive Royal Assent shortly. The main point covered by this legislation is the anticipated changes to the state pension age.

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