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Automatic Enrolment of Workers into Pension Schemes (Updated, June 2012)

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What is happening?

All employers operating in the UK will soon be subject to a new duty to enrol eligible workers automatically into a qualifying pension scheme and pay a minimum level of contributions for those who are enrolled.

As a general rule, with effect from the day that an employer becomes subject to this new duty, it must ensure that all of its eligible workers are automatically enrolled (for joiners after that date, it would be their first day of employment).

Employers can decide to introduce a deferral period, but a worker's automatic enrolment date can only be postponed by up to three months (and the worker can still 'opt in' within this period). There is a notice procedure to go through to achieve this. Most employers are expected to take advantage of this deferral period as it gives a little more flexibility in terms of probationary periods (of three months or less) or aligning the automatic enrolment date with the employer payroll.

When will this new duty apply?

The duty will be introduced in October 2012 for very large employers. Extensions may yet be introduced but, as things stand, the implementation is then staggered, for decreasing-sized employers (based on the number of people they employ) through to April 2017 (there are some later 'staging dates' for new employers), although an employer can voluntarily comply with the new requirements early if it chooses. For example, an employer with between 350 and 499 people on its payroll (as at 1st April 2012) will have to comply with the new duties from 1st January 2014.

The Pensions Regulator will write to all employers around 12 months before the new duties are scheduled to apply to them.

The following link to the Pension Regulator's website shows how the various staging dates will be staggered - www.thepensionsregulator.gov.uk/employers/staging-date-timeline.aspx.

Who will be eligible?

A lot of detail is contained in the legislation, but in summary, and as things currently stand, a worker will be a 'jobholder' who must be automatically enrolled if the following three conditions are met:

- The worker works (or normally works) in Great Britain under ‘a contract of employment’ (this will include temporary and casual workers). Agency workers will likely need to be automatically enrolled by the agency itself rather than by the end user, but this will depend on the particular circumstances.

- The worker is aged between 22 and state pension age (although some workers aged between 16 and 22, or state pension age and age 75, can also choose to opt in)

- The worker earns more than the income tax threshold, i.e., £8,105 p/a for the 2012/13 tax year (although it is possible for lower earners to opt in). Earnings are widely defined to include, e.g., wages, commission, bonuses, overtime and maternity, paternity, adoption or statutory sick pay.

Opting Out

It will be possible for workers to opt out of a pension scheme, but only once they have been automatically enrolled. They must then be allowed to opt in again once a year, and be automatically enrolled again every three years. Workers can, however, choose to opt out again.

Employers must not take any action (or fail to take any action), the ‘sole or main purpose’ of which is to induce a worker to opt-out of a pension scheme. For example, there should be no implication that an offer of employment is conditional upon a worker opting out.

What pension arrangements can employers use to satisfy the duty?

Employers can use existing or new pension schemes. These can be defined benefit (“**DB**”) or defined contribution (money purchase) (“**DC**”) schemes operating on a trust or contract basis, provided the scheme meets certain qualifying criteria.

Alternatively, employers may use a central scheme such as the National Employment Savings Trust (“**NEST**”). NEST is a Government-established, national trust-based DC pension scheme which will be open to all employers, but which has been designed specifically for low-earners and others who are new to pension saving.

What are the qualifying tests for existing or new pension schemes?

DB schemes

Contracted-out DB schemes automatically satisfy the qualifying tests so long as the employer holds a valid contracting-out certificate that has been issued by HMRC.

DB schemes that are not contracted out 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 at least 1/120th of average earnings in the past three years multiplied by service to a maximum of 40 years, and provide revaluation and increases in line with the statutory minimum.

Given these specific funding standards, there are no minimum contribution requirements. In practice, many registered DB schemes will meet the qualifying test. However, certification of this should be sought from the pension scheme actuary.

For DB schemes, transitional arrangements will allow the employer to delay automatic enrolment even if the employer's staging date is earlier (although this is subject to various conditions). However, eligible workers will be able to opt into their employer's DB scheme during this transitional period, if they wish. The precise length of this period for DB schemes has not yet been set. Originally set at four years, the DWP proposed in March 2012 increasing it to five years, ending 30th September 2017.

DC schemes (including occupational DC schemes or group personal/stakeholder pension schemes)

For DC schemes, the qualifying test depends on contribution levels and on how pensionable salary is calculated.

The total minimum contribution required will be 8 percent of 'qualifying earnings' for each eligible worker (specific definitions of 'pay' will be taken into account for self-certifying DC schemes – see below). The 8 percent consists of:

- 3 percent employer contribution
- 4 percent member contribution
- 1 percent tax relief

However, the overall level of contributions is what matters – employers can contribute in excess of the 3 percent minimum if they wish.

A reduced contribution rate applies for a transitional period. For employers, this is a contribution rate of 1 percent from their staging date up to 30th September 2017, and 2 percent between 1st October 2017 and 30th September 2018.

Can an employer self-certify in advance that its existing DC pension scheme meets the qualifying tests?

Yes, to simplify the process, employers with an existing DC pension scheme will be able to self-certify in advance that the scheme meets the minimum quality requirements.

This facility was introduced following concerns by industry bodies about the administrative complexities involved for employers in having to satisfy the quality requirements (most employers with DC schemes calculate pension contributions by reference to 'basic salary' rather than 'qualifying earnings' as used in the automatic enrolment qualifying test for DC schemes set out above). Employers will be able to certify compliance with the certification requirements if it provides contributions on one of the following bases:

- Contributions of at least 9 percent of pensionable pay, including a 4 percent employer contribution
- Contributions of at least 8 percent of pensionable pay, including a 3 percent employer contribution, provided at least 85 percent of the relevant payroll is pensionable
- Contributions of at least 7 percent of pensionable pay, including a 3 percent employer contribution, provided all the relevant payroll is pensionable

General Points

- All pension schemes used to satisfy the new employer duties will have to meet certain eligibility criteria and comply with information and record-keeping requirements.
- Employers and trustees cannot make automatic enrolment conditional upon any other action, such as requiring workers to provide signed documentation or make a particular investment choice when being automatically enrolled.

Are the minimum contributions to NEST the same as for existing or new DC schemes?

Yes, this will be the same, i.e., 8 percent of “qualifying earnings’ for each eligible worker.

What if an employer fails to comply with the new duties?

The Pensions Regulator is tasked with enforcing compliance of the new employer duties and can issue substantial penalty notices to employers (which can amount to up to £10,000 per day for employers with 500 or more workers). Wilful failure to comply could also amount to a criminal offence, punishable with a fine, up to two years in prison, or both.

What has this got to do with pension scheme trustees?

The Pension Regulator points out that, although these duties will predominantly apply to employers, trustees will 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 automatic enrolment requirements
- Discuss automatic enrolment with the scheme’s sponsoring employer to determine if their pension scheme can or will be used to meet the automatic enrolment requirements
- Respond to any queries 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 automatic enrolment regime and how, the follow-up action for trustees could be minimal or quite significant.

Some practical tips - what should employers be doing to prepare for automatic enrolment?

- Confirm your employer's staging date and consider bringing it forward/postponing it - employers need to recognise that the new obligations will soon apply to them, and work out when they will first be affected.

- Assess the workforce – employers should profile (and have processes in place to profile on an ongoing basis) their workforce to identify who is an 'eligible jobholder', who is a 'non-eligible jobholder' and who is an 'entitled worker' (as defined in the legislation), i.e., broadly, who must be automatically enrolled into a pension scheme and receive employer contributions, who will be entitled to 'opt in', and who will be entitled to join a scheme but with no employer contribution requirement.

- Particular complications can arise for temporary or seasonal workers, or workers whose salaries are likely to fluctuate above and below the minimum level of qualifying earnings. Any agency workers and internationally mobile employees need to be considered carefully.

- Identify which qualifying pension scheme(s) to use to comply with the new duties.

- Plan the implementation and ongoing administration process – employers should ensure appropriate HR, IT and payroll systems are put in place to:

    - Identify workers who are eligible for automatic enrolment

    - Make deductions of contributions into the pension scheme

    - Provide relevant information to the different categories of worker

    - Process opt-ins

    - Process opt-outs and refund contributions when a worker opts out within one month of entry into the scheme

    - Keep records (for six years, or four years in relation to opting out)

In relation to this, the timing and content of employee communications about automatic enrolment will also be important for a successful programme, and there are strict requirements as to what information needs to be provided and when.

- Employment documentation (and any salary sacrifice or flexible benefits arrangements) should also be reviewed to ensure that the statutory requirements are met.

- Register online with the Pensions Regulator in good time of the employer's staging date.

- Review recruitment and training procedures.

- We have found that many employers have used the automatic enrolment duties as an opportunity to carry out a general ‘pensions health check’ on the pension benefits they offer their workers.

Disclaimer

Please note that some of the details in respect of these new pensions ‘automatic enrolment’ obligations have not yet been finalised and are therefore subject to change.

If you are interested in exploring further any of the issues raised in this Alert, we would be happy to discuss them with you.

About Reed Smith

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This Client Alert was compiled up to and including June 2012.