

# Automatic enrolment in a pension scheme: New employer duties

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## For the first time, all employers will have to enrol their staff in a pension scheme and contribute for them.

Employees will also have to contribute unless they opt out.

Auto-enrolment is expected to lead to millions of people saving for a pension for the first time.

The introduction of auto-enrolment is the most radical change in pensions policy for decades. For many employers it will lead to significant extra cost in contributions and administration.

The duty to enrol staff automatically phases in between October 2012 and February 2016, starting with the largest employers. There are no exceptions even for the smallest employers.

A defined benefit (DB) scheme that is used for auto-enrolment must provide a minimum level of benefit. In a defined contribution (DC) scheme there is a minimum employer's contribution. An employer will be able to choose to provide a DC scheme.

The legislation creating the auto-enrolment duty is some way from being complete. The government is still considering proposals put forward by the review it commissioned when it came into office. The broad outline of the duty is clear but there is still uncertainty over a significant amount of the detail.

## Employer's duty

An employer will have to enrol **eligible jobholders** automatically in a **qualifying scheme** (unless they are already in one).

These are among several important terms that keep coming up. This is what they mean.

Broadly, a **jobholder** is someone who:

- is engaged under an employment contract or a personal services contract and ordinarily works in Great Britain,
- is at least age 16 but is under 75 and
- receives **qualifying earnings**.

Employed directors and temporary staff are included. So too are agency workers who are paid by the employer.

In short, auto-enrolment applies to a wider class of people than employees.

An **eligible jobholder** is a *jobholder* who:

- is at least age 22 but is under state pension age and
- earns at or above the income tax threshold\* (£7,475 p.a. in today's terms).

**Qualifying earnings** means the band between £5,715 and £38,185 p.a. (in today's terms). Fluctuating amounts like commission, bonuses and overtime, and certain statutory payments like maternity pay are included.

A **qualifying scheme** is an occupational or personal pension scheme (at the employer's choice) that passes a quality test (see below). An occupational pension scheme can be DB or DC (or hybrid).

An employer's auto-enrolment procedures must not require a jobholder to take any active part in joining the scheme e.g. make a choice about anything or provide information. Anyone auto-enrolled must be given specified information.

## Quality test for qualifying scheme

The current legislation sets out quality tests for DB and DC *qualifying schemes* but the government is looking at simplifying the DC test.

### Quality test – current legislation

In the long term the quality test for a DC occupational scheme is that:

- the employer is required to contribute at least 3% of the *jobholder's qualifying earnings* and
- the total contribution by the employer and the *jobholder* is at least 8% of *qualifying earnings*.

But for the first five years the minimum contributions are lower. See below.

The quality test for a personal pension scheme is similar.

The test for a DB occupational scheme is broadly that:

- the *jobholder* is in contracted-out employment or
- for at least 90% of its members, the scheme provides benefits at age 65 broadly equivalent in value to 1/120th for each year of service (maximum 40) of an average of *qualifying earnings* over the last three tax years of service (plus statutory increases).

\*Proposal from the October 2010 review that the government is expected to adopt.

A CARE scheme passes the quality test if it either (a) revalues accrued benefits at a minimum of (probably) CPI capped at 2.5% while the member remains in pensionable service or (b) allows for this as a matter of discretion and funds for it.

It is likely to be the scheme actuary who certifies that a DB scheme passes the test.

An employer with a scheme that already meets the quality test may well decide to use it for auto-enrolment.

### Quality test – simplified proposal for DC schemes

Few existing DC schemes use a definition of pay that is close to *qualifying earnings*. Hence the review proposal to allow a scheme to satisfy the quality test if it requires minimum contributions on any one of these footings:

- 9% of pensionable pay however defined, including 4% from the employer,
- 8% of pensionable pay, including 3% from the employer, provided that pensionable pay makes up at least 85% of the total payroll or
- 7% of pensionable pay, including 3% from the employer, provided that the total payroll is pensionable\*.

A test along these lines would mean many employers would be able to use their existing DC schemes for auto-enrolment with minimal changes.

### Phasing in

Auto-enrolment is being phased in.

First, there is a “staging date” between October 2012 and February 2016 when an employer first comes under a duty to enrol staff automatically. The bigger the workforce, the earlier the date.

Secondly, once someone is enrolled, the minimum rate of accrual builds up gradually.

### Staging dates

An employer’s staging date depends on the number of people in its PAYE scheme on 1 April 2012.

The full list of dates is available on the Pensions Regulator’s website●; here some samples:

<b>120,000 or more</b>	1 October 2012
<b>6,000 – 9,999</b>	1 April 2013
<b>800 – 1,249</b>	1 October 2013
<b>150 - 239</b>	1 May 2014
<b>&lt; 50</b>	Dates between 1 March 2014 and 1 February 2016

However, an employer can postpone auto-enrolment for up to three months\*. This administrative easement applies in relation to *jobholders* in post on the staging date and to those who become eligible for auto-enrolment subsequently. During the postponement those affected can opt to join the scheme and receive contributions from the employer.

New employers that come into existence in April 2012 or later have staging dates from March 2016 onwards.

### Pension accrual: DC and personal pension schemes

The long term minimum contribution to a DC scheme of 8% is reached gradually over an introductory period of five years.

	<b>10/12 - 9/16 (4 years)</b>	<b>10/16 - 9/17 (1 years)</b>	<b>10/17 onwards</b>
<b>Minimum employer contribution</b>	1%	2%	3%
<b>Member contribution (+ tax relief) and/or extra employer contribution</b>	1%	3%	5%
<b>Minimum total contribution</b>	2%	5%	8%

The minimum percentages apply to a member’s *qualifying earnings* (and not just to earnings above the income tax threshold). Employers and members can contribute more than the minimum.

### Pension accrual: DB schemes

An employer with a *qualifying scheme* that is DB has the option to delay auto-enrolment until (probably) October 2016 for any *eligible jobholder* who was already in post and eligible to join the scheme on the employer’s staging date and subsequently remains eligible.

### Opting in

*Jobholders* who are not subject to auto-enrolment (because outside the age band, say) can require their employer to enrol them in a *qualifying scheme*. The employer must inform them of this right and must contribute in the same way as for someone enrolled automatically.

Workers who do not receive *qualifying earnings* can also require their employer to enrol them in a pension scheme. They must be informed of this right but the scheme need not be a *qualifying scheme* and the employer need not contribute.

### Opting out

A *jobholder* who has been automatically enrolled can opt out by giving notice within a month. The wording of the notice is prescribed and includes warnings about the consequences of opting out.

●www.thepensionsregulator.gov.uk/pensions-reform/duty-dates-timeline.aspx.

\*Proposal from the October 2010 review that the government is expected to adopt.

The *jobholder* must obtain the form from the scheme and fill it in. This strict procedure appears to be designed to dissuade the less determined. The *jobholder's* contributions must be refunded.

## Automatic re-enrolment

A *jobholder* who has opted out must be re-enrolled automatically within three months\* (either side) of the third anniversary of the employer's staging date. And so on every three years if they continue to opt out.

But this does not apply to someone who opted out in the twelve months before a re-enrolment date.

## NEST

The National Employment Savings Trust or NEST is an occupational DC scheme set up under legislation as an option for dealing with auto-enrolment. It is designed chiefly for the smaller employers that the pensions industry has found it difficult to provide for economically.

Initially contributions will be capped at £4,300 p.a. (in today's terms) and no transfers (in or out) will be allowed.

## Anti-avoidance measures

There are strong measures to head off attempts to avoid the auto-enrolment duty. And potentially heavy penalties for non-compliance. Evidently, the government means auto-enrolment to work.

Employers are prohibited from:

- indicating (directly or indirectly) during recruitment that the outcome could depend on whether a candidate might opt out of auto-enrolment,
- inducing *jobholders* to opt out,
- doing anything to end a *jobholder's* active membership of a scheme and
- subjecting a *jobholder* to detrimental treatment because they have asserted their auto-enrolment rights.

In addition:

- dismissing an employee for asserting their rights counts as unfair dismissal for employment law purposes and
- an agreement whereby someone contracts out of their auto-enrolment rights is void (with limited exceptions).

There can be fines and prison for non-compliance.

## Financial penalties

The Pensions Regulator has lead responsibility for enforcement. It is making clear that it will rely initially on encouragement and education and only turn to punishment as a last resort. Its weapons include compliance notices (requiring an employer to remedy a failing) and unpaid contribution notices. It can turn up the pressure with a fixed penalty notice (maximum £50,000) or an escalating penalty (up to

£10,000 a day).

## Criminal penalties

An employer commits a criminal offence if it wilfully fails to enrol or re-enrol someone automatically or denies them their rights to opt in. This can lead to a criminal fine and/or prison.

Where the employer is a company, an officer (e.g. a director) or senior manager who consented to, or connived with, the default is guilty of the same offence as the company.

The sanctions regime is backed by wide-ranging requirements for employers to keep records and supply the Regulator with information.

## Action points for employers

- When is your staging date? Check on the Pensions Regulator's website.
- How will you budget for the increased costs and annual pay reviews?
- Are there people who are likely to want to opt out in order to preserve their tax position e.g. because they are entitled to "enhanced protection" following the A Day tax changes?
- Will your existing scheme count as a *qualifying scheme*? If not, can it be amended? Or will you create a new scheme specifically for auto-enrolment? If this is DC, how will you go about picking a suitable default investment option? Or will you use NEST as your scheme?
- How will your HR practices and processes need to change e.g. will you need new software to keep track of the data (e.g. age and *qualifying earnings*) that dictate when you must enrol or re-enrol someone automatically? How will you communicate about pensions during recruitment and later on?
- What is the likely cost of implementing auto-enrolment (apart from contributions)?
- Have you begun to develop a timetable for auto-enrolment?
- There is a lot of legislation and regulatory guidance to be published over the coming months. Do you have an individual or team briefed to absorb it?
- Taking a wider view, is it time for a strategic review of your pension arrangements and employment practices? Are they fit for purpose in the light of auto-enrolment, the abolition of the default retirement age, a rising state pension age, the need for longer working lives and increased interest in flexible retirement?

## More information

If you would like more information, please get in touch with your usual contact in our pensions team or with **Marcus Hellyer on 0117 902 7789 or at [marcus.hellyer@burges-salmon.com](mailto:marcus.hellyer@burges-salmon.com)**.

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\*Proposal from the October 2010 review that the government is expected to adopt.