MAYER • BROWN

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Compulsory Pension Provision in the UK – More Detail

Introduction

The Government last week published its second batch of draft legislation about the introduction of personal accounts. The legislation is to come into effect in the autumn of 2012.

In addition, it released a further consultation on how to design a "default investment option" for workplace personal pensions and the use of group SIPPs for automatic enrolment. A significant amount of further detail has now been provided.

We cover the key areas in this alert.

1. Responses to the March consultation

The new draft regulations take on board some concerns of the pensions industry arising from the initial draft regulations issued in March. For example, the period over which a member has to be "auto-enrolled" into either the new personal accounts pension scheme or a workplace scheme which provides comparable or better benefits has been extended from 14 days to one month. There is also some simplification of the proposed timescales and information provisions. In the context of contract-based DC arrangements it was accepted that there was a significant overlap between existing FSA requirements and the requirements of the DWP, and this has been addressed.

This is a welcome relaxation.

Where a member opts-out, the period for paying refunds has been extended to allow for payment at the same time as other wages. An additional simplification, intended to limit the need for refunds, is that regulations will amend existing legislation so that contributions do not need to be paid over until the 19th day of the month following the month in which contributions become due.

This too is a welcome relaxation.

However, the opt-out process remains rigid: the opt-out form will still have to be in a prescribed form, it can be invalidated for technical reasons (such as the member not including his date of birth or national insurance number) and, in order to be valid, the form will still have to be obtained from the scheme (and not the employer) but returned to the employer (not the scheme).

On the last point the Government says that existing processes for schemes will be able to continue; so that where the scheme administration is delegated to the employer, a dedicated person there can provide the opt-out forms. In our view the draft legislation should be clarified.

2. Implementation of the reforms

The Government proposes staggered implementation of the reforms over a three-year period from October 2012, starting with the largest employers and moving to the smallest in over 25 stages. The precise detail of this process, and in particular identifying the "profile" of larger, medium and small employers, is currently under review and will be contained in the final version of the regulations.

It is helpful that the Government has not gone with the "big bang" approach of introducing the reforms all on one day. But larger employers will nevertheless need to start thinking about meeting their duties as soon as possible.

The Regulator will write individually to all employers about 12 months and 3 months in advance of their automatic enrolment date (or "staging date") to tell them when they need to take action and what they need to do to comply. It is proposed that employers will be able to bring forward their staging date to a specified date after October 2012 (i.e. to a date earlier than when they would otherwise have become subject to the duties) if it is helpful to do so, for example, to align with administration processes.

Employers should consider whether they would like to take up this option. This may be particularly relevant for large groups with employers who may have different staging dates.

3. Transitional periods

The Government is also consulting on measures to phase in minimum contribution requirements over time, in order to help employers and individuals adjust to the additional costs gradually. It is proposed that employers using DC schemes be required to pay contributions of:

- 1% (of the jobholder's "qualifying earnings" – which basically means all their earnings between £5,035 and £33,540 in 2006/2007 terms) from October 2012 for three years;
- 2% for year 4; and
- 3% from year 5 onwards.

The Government proposes to let employers sponsoring DB schemes delay automatic enrolment until the staging period of 3 years has ended for those jobholders who continue to be entitled to become a member of a qualifying DB or hybrid scheme.

Employers who close their DB scheme during the 3 years must automatically enrol workers into an alternative qualifying scheme. Where that alternative is a DC scheme they will need to pay employer contributions with effect from the original automatic enrolment date, which could amount to 3 years' worth of contributions.

This may be a further incentive for employers to bring forward any plans they have to close DB schemes before October 2012.

4. Burdens on employers

Some of the notable requirements are as follows:

(a) Employers will be required to write to workers who do not automatically qualify for auto-enrolment informing them that they have the right to join the scheme.

If the worker joins, but does not have qualifying earnings (£5,035 in 2006/2007 terms) the employer will not be required to contribute. If the worker has qualifying earnings, but is below 22 or above pensionable age, the employer will be required to contribute.

(b) Employers will still be required to notify existing active members of a qualifying scheme that they are members of such a scheme – although the time scale for this has been extended.

This places an additional administrative burden on employers.

(c) A requirement to auto-enrol qualifying jobholders into the qualifying scheme on every third anniversary of the "staging date". (However, where a jobholder opts out there will generally be no requirement to auto-enrol him or her back into the scheme within a year.)

Given the potential significance of this date, employers may want to bring forward the staging date to align this with administration processes.

(d) The three month postponement of auto-enrolment, for good quality schemes, will not apply to jobholders on short-term contracts.

Employers may have to think about alternative pension arrangements for any agency workers or other workers on short-term contracts.

(e) Employers will be required to provide information about how they have met their automatic enrolment duties, via a process of registration. It is proposed that employers will be required to register within 9 weeks after their staging date and to re-register every 3 years.

(f) Employers, trustees and managers of pension schemes and pension providers will be required to keep records about the pension arrangements they have made, the enrolment of job holders and the "opt-out" and "opt-in" processes, and the pension contributions they have made. It is proposed that these records should be kept for a period of six years.

5. Self-certification and quality requirements

The Pensions Act 2008 provides a mechanism for schemes to certify that they meet the qualifying requirements.

(a) *DB schemes*

Where employees are contracted-out on the reference scheme test basis, the scheme will automatically qualify. For other final salary schemes, the schemes must provide benefits at least as good as a "test scheme" – which is a scheme providing accrual of 1/120th of qualifying earnings over a maximum of 40 years of pensionable service, and with a pension age equal to State Pension Age (which is age 65 increasing to age 68). An employer can self-certify in straightforward cases; if the scheme is better in all respects than the test scheme. In other cases, the scheme actuary will need to be satisfied, in accordance with guidance, that the scheme is actuarially equivalent to the test scheme.

There are different rules for other DB schemes, and in some cases there will be modified "test schemes". For career average schemes, in order for the scheme to qualify benefits have to be revalued in the same way as final-salary benefits. The Government is consulting on whether schemes can still qualify where there is an employer and/or trustee discretion to revalue benefits.

Employers will be pleased that there is an ability to self-certify but in cases relying on the "test scheme", the scheme actuary will need to be involved.

(b) *DC schemes*

Many schemes use pensionable pay definitions which do not correspond exactly to the ones used in legislation. This is because, as mentioned earlier, "qualifying earnings" for the purposes of the legislation covers all remuneration between £5,035 and £33,540 (in 2006/2007 terms), while many schemes pension basic salary only.

It will be possible to use a 12-month period (or shorter certification period, where for example significant events such as a corporate transaction occurs) over which to assess whether pension contributions meet the minimum requirements. When the certificate expires, the employer must consider whether the scheme meets the quality requirements using a number of sample checks. For example, the quality requirement will not be satisfied if a jobholder experiences a shortfall of more than 5% of the minimum total contributions under legislation, or more than 10% of the work-force experience any shortfall in contributions.

Employers need to consider what systems need to be put in place for measuring the quality requirements.

(c) *Hybrid schemes*

For cash balance schemes, the Government is suggesting a minimum requirement of (A) an annual credit of 8% of qualifying earnings with increases of 3.5% over and above limited prices inflation capped at 2.5% or (B) annual credits of 16% of qualifying earnings with annual increases of limited prices inflation capped at 2.5%.

The rules here are complicated, and may be a disincentive for employers wishing to put in place risk-sharing pension arrangements.

6. Time limits on inducements and compliance action

The Pensions Act 2008 prohibits employers from attempting to induce individuals to leave a pension scheme. Two time limits are prescribed for enforcement in relation to inducements; 6 months for individuals to make a complaint to the Regulator about being induced to leave pension saving and 12 months for the Regulator to initiate an investigation in the absence of a complaint.

7. Penalties

Flat-rate fixed penalties of £500 and escalating daily penalties that vary by employer size are proposed together with stringent interest penalties for non-/ late payment of contributions. The fixed penalty will be imposed where employers fail to engage with the reforms despite the provision of information and support. The daily escalating penalty (from £50 per day to £10,000 per day depending on the size of the employer ranging from 1-4 workers to 500+ workers) is intended to target more entrenched non-compliance.

8. The use of default options for workplace personal pensions and the use of group SIPPs for automatic enrolment

The consultation paper also proposes that, in the context of group personal pension arrangements, the pension provider will be mainly responsible for setting and reviewing the default investment option, but that it should consult with the employer and give it various options. The provider will need to have regard to some high-level principles which include requirements relating to affordability, de-risking and asset allocation.

Employers will, therefore, need to increase their governance efforts with contract-based schemes.

The consultation paper also proposes that jobholders should be automatically enrolled only into a group SIPP's default fund; which should resemble that of a group personal pension scheme, have a comparable pricing structure to a group personal pension scheme and comply with the guidance described above. It should not automatically offer a self-investment option at automatic enrolment, but - once enrolled - the member would be able to invest in other pooled retail funds with a charging structure similar to that of a group personal pension scheme. The consultation paper indicates that members who are automatically enrolled should not have to pay for investment options they are not using.

It is helpful that group SIPPs will be allowed but employers should consider whether they are really suitable for auto-enrolment.

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