MAYER • BROWN

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Automatic enrolment

Employer duties

AUTOMATIC ENROLMENT

1. What should employers be doing?

With the automatic enrolment implementation process now underway, many employers are planning ahead on the design of future pension provision. Some practical steps that employers can take now in anticipation of their Staging Date are as follows:

(a) Confirm Staging Date and consider bringing it forward

Confirm the Staging Date and consider whether to accelerate that date (for example, to ensure a consistent approach amongst a group with different employers). The Pensions Regulator has published a Staging Date timeline on its website.

(b) Assess the workforce

Determine which employees are eligible jobholders, non-eligible jobholders or entitled workers. Eligible jobholders must be automatically enrolled into an automatic enrolment scheme, whilst non-eligible jobholders can opt into automatic enrolment. Entitled workers can also opt into enrolment but the employer need not pay contributions in respect of such employees. The Pensions Regulator has published guidance on this and a summary diagram which may be helpful.

(c) Looking at existing pension arrangements

(i) Consider whether to adapt existing pension schemes for (a) existing employees, (b) new employees and (c) any entitled workers who choose to opt into automatic enrolment.

(ii) For occupational pension schemes, liaise with the trustees regarding any changes which are needed.

(iii) Some employers will be considering alternative arrangements. The governmental scheme, NEST, may be an appropriate alternative vehicle, whilst a number of private sector pension providers are offering trust and contract-based vehicles specifically designed for automatic enrolment.

(iv) Particular complications may 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 need to be considered carefully.

(d) Plan the implementation process

(i) Assess the cost of implementing and sustaining automatic enrolment, including the anticipated number of employees who will opt out. Employers may need to consider reducing salaries or other benefits (pensions or otherwise) to compensate for the increased cost.

(ii) A 60 day consultation process would be needed where pension benefits are reduced. Longer consultation is likely to be needed to change other employment terms.

(iii) Where employers have a defined benefit or hybrid scheme open to accrual, consider the benefit of the five-year transitional period to delay implementing automatic enrolment for relevant staff.

(iv) Consider the benefit of postponing automatic enrolment for new joiners. This is likely to be important for employers that currently operate a waiting period to join a pension arrangement, or other employers who have a high turnover of staff.

(v) Where a personal pension scheme is to be used, liaise with the provider to ensure that the additional requirements are met. These requirements are that the scheme is FSA-regulated; that it provides only money purchase benefits; and that there be agreements in place between the provider and (a) the employer that the minimum employer contribution will be made and (b) the employee that any shortfall in the total minimum contribution will be met.

(e) Review employment documentation and practices

(i) Review employment documentation to ensure that the statutory requirements are met. This may include facilitating automatic enrolment or amending rates of employee and employer contributions.

(ii) Salary sacrifice and flexible benefits arrangements will need to be reviewed and potentially restructured in light of automatic enrolment to ensure that they are operated in a way which is consistent with the automatic enrolment legislation.

(iii) Recruitment practices will need to be reviewed to ensure no inadvertent breaches of the employer duties occur.

(iv) Data about employees must be provided to the scheme. Employers will be concerned about data protection issues where information is passed on to scheme administrators, and may wish, if not already included, to put explicit consent to the use of personal data in the employment contract.

(v) Defined contribution and hybrid schemes must select an appropriate default investment option for the scheme/defined contribution section. The DWP has produced guidance on choosing the default investment option which is available on its website. Consideration should also be given to whether any changes will be needed to the range of investment options in light of the post-automatic enrolment membership profile.

(f) Plan the ongoing administration process

(i) Appropriate systems are needed for record-keeping and to ensure compliance with the obligations to register with and report to the Pensions Regulator and to provide information to the scheme.

(ii) Monitoring systems may need to be put in place for employees with fluctuating earnings.

(iii) Where the administration of benefits is carried out in-house, consider amending the scheme's trust deed and rules to explicitly provide that administration is carried out by the employer e.g. to enable the employer rather than the scheme to manage opt-outs.

(iv) Employers and high-earners will want to ensure that the automatic enrolment requirement does not result in any employees with enhanced or fixed protection inadvertently losing the benefit of such protection.

(v) Looking further ahead, the opt-out and automatic enrolment processes are likely to be complicated. Employers will want to consider the changes to administration systems which need to be made to ensure that the timescales are met and contributions are paid.

(g) Prepare employee communications

The timing and content of employee communications about automatic enrolment will be crucial for a successful programme. The Pensions Regulator has published a quick reference guide to the information which must be provided to employees.

The Pensions Regulator has published a range of guidance on automatic enrolment which employers may find helpful. This guidance can be found on the Pensions Regulator's website.

2. Executive Summary

A package of private pension reforms took effect in October 2012, compelling employers for the first time to make pension contributions for more or less all their employees. The main structure of the legislation is set out in the Pensions Act 2008 and regulations issued under it and amendments to this brought by the coalition government were enacted in the Pensions Act 2011, which was given Royal Assent on 3 November 2011, and subsequent regulations.

In summary, the new regime requires all UK employers to make arrangements for automatic enrolment of all jobholders (which is drafted widely to include agency workers):

(a) aged between 22 and state pension age; and

(b) who are being paid more than the 'earnings trigger', which is to be set at the threshold for paying income tax: £8,105 in 2012/13[1],

("eligible jobholders") into an "automatic enrolment scheme", unless the jobholder is already a member of a "qualifying scheme".

1 The earnings trigger is subject to annual review.

To assess whether a person has reached the earnings trigger, wages, commission, bonuses and statutory maternity/paternity/adoption/sick pay must be taken into account. Contributions will be in respect of and by the jobholder in accordance with qualifying earnings (see 3 below "Which employees must be offered benefits").

If employers do not have a qualifying scheme, or have a scheme that does not pass the statutory tests, or do not wish to establish an automatic enrolment scheme, they can use the National Employment Savings Trust ("NEST") set up by the government.

3. Which employees must be offered benefits?

The legislation refers to "jobholders". These are employees who:

(a) work mainly in the UK;

(b) are aged between 16 and 74; and

(c) are paid "qualifying earnings" (broadly gross earnings including bonuses and overtime above £5,564 in 2012/13). Earnings need only be pensioned up to an upper limit (£39,853 in 2012/13).[2]

Gross earnings includes any salary, wages, commissions or bonuses, as well as any statutory payments on sick leave and maternity, paternity and adoption leave, or other prescribed payments.

Where a jobholder is aged between 22 and state pension age, the automatic enrolment provisions bite, although in some cases employers can postpone the application of the legislation for a period of three months after the jobholder's automatic enrolment date - see 8 below "How does automatic enrolment work?".

Voluntary savers

Certain employees are not eligible to be enrolled automatically as they are aged under 21 or over state pension age and/or their earnings are below the earnings trigger. Such employees fall into two categories:

(a) non-eligible jobholders: employees who:

(i) are aged between 16 and 74 and whose earnings are above the lower end of the qualifying earnings band, but below the earnings trigger; or

(ii) are aged between 16 and 21 and whose earnings exceed the earnings trigger; or

(iii) are aged between state pension age and 74 and whose earnings exceed the earnings trigger,

(b) entitled workers: employees whose earnings are below the lower end of the qualifying earnings band.

Non-eligible jobholders are able to opt into auto-enrolment by serving notice on their employer requiring their employer to admit them to membership of a qualifying scheme. Once a non-eligible jobholder has given such a notice, they are to be treated

2 The qualifying earnings band is subject to annual review.

in the same way as someone who was automatically enrolled in the scheme. This includes complying with the minimum (equivalent) contribution levels. Employers must inform non-eligible jobholders of their right to opt-in and provide certain prescribed information.

Entitled workers are able to opt into automatic enrolment by serving notice on their employer. Once an entitled worker has given such a notice, the entitled worker must be admitted to membership of a registered pension scheme. However, this scheme does not need to be a qualifying scheme and as a result, the employer contributions paid on behalf of the entitled worker do not need to satisfy the minimum thresholds for qualifying schemes (see 5 below "What is a qualifying scheme?") i.e. the employer does not need to pay contribution in respect of an entitled worker.

Opting out

Automatic enrolment itself is compulsory but once automatically enrolled, a jobholder has one month from becoming an active member to give the employer a valid opt out notice – see 8 below "How does automatic enrolment work?".

4. What is an automatic enrolment scheme?

In order to constitute an automatic enrolment scheme, a scheme must:

(a) be a "qualifying scheme" (see 5 below "What is a qualifying scheme?");

(b) be an occupational pension scheme established in the UK or the EEA or a personal pension scheme established in the UK or the EEA whose provider is authorised by the competent authority[3]; and

(c) not contain any provisions which would:

(i) prevent the employer from using the scheme to meet its automatic enrolment obligations; or

(ii) require the jobholder to make any choice or provide any information in order to become a member.

Most existing UK schemes will meet the above criteria, although it may still be necessary to amend the eligibility provisions.

5. What is a qualifying scheme?

Generally speaking, in order for a scheme to "qualify" under the new statutory standard the scheme must:

(a) be an occupational pension scheme that has its main administration in the UK or a personal pension scheme[4];

(b) be a registered pension scheme[5]; and

(c) satisfy certain prescribed quality requirements.

3 Where the scheme is established in the EEA, certain additional requirements must be satisfied.
4 Certain other types of pension schemes may also qualify.
5 Certain non-registered schemes may also qualify.

In addition, administration charges under the scheme must not exceed an amount to be prescribed by regulations[6]. "Administration charges" for these purposes include any deductions made from contributions, investment returns and scheme benefits which are used to cover the scheme's administrative expenses, to pay commissions or in any other way which does not result in the provision of benefits for or in respect of members.

The quality requirements which must be satisfied are summarised below:

Defined contribution schemes

Where employers operate defined contribution occupational pension schemes, or direct payment arrangements for personal pension schemes, they must contribute at least 3% of the jobholder's qualifying earnings over a 12 month period.

Total contributions, including tax relieved contributions from the jobholder and contributions from the employer, must be at least 8% of the jobholder's qualifying earnings over a 12 month period. (The 8% breaks down as 4% from the jobholder, 1% of tax relief and 3% from the employer.)

In recognition of the fact that most contribution structures are based on pensionable earnings rather than the statutory definition of "qualifying earnings", regulations provide that, as an alternative, employers will be able to certify that the contribution structure they operate satisfies one of the following three alternative thresholds based on contributions as a percentage of pensionable pay as opposed to qualifying earnings (taking into account the 1% tax relief):

(a) threshold 1: the total contributions must be at least 9% of pensionable pay with the employer contribution being at least 4% of pensionable pay provided that pensionable pay is equal to or exceeds basic pay;

(b) threshold 2: the total contribution must be at least 8% of pensionable pay with the employer contribution being at least 3% of pensionable pay provided that pensionable pay is equal or exceeds basic pay and at least 85% of the aggregate earnings of all the relevant jobholders is pensionable pay; and

(c) threshold 3: the total contribution must be at least 7% of pensionable pay with the employer contribution being at least 3% of pensionable pay provided that all earnings are pensionable pay.

Basic pay for these purposes is defined as gross earnings excluding commission, bonuses, overtime and similar payments, shift premiums and certain "reasonable allowances" such as relocation allowances.

Existing defined contribution schemes which appear to meet this test should still be checked as there can be a mismatch between, for example, the underlying earnings definitions on which contributions are based.

6 No limit on administration charges has yet been announced.

In addition, where a personal pension scheme is concerned:

(a) the scheme must be regulated by the FSA;

(b) the scheme must only provide money purchase benefits;

(c) there must be an agreement between the scheme provider and the employer for the employer to make the minimum employer contribution (i.e. 3% or 4% depending on the contribution structure being used); and

(d) there must be an agreement between the scheme provider and the jobholder for the jobholder to make up any shortfall between the employer contribution and the minimum total contribution of 7%, 8% or 9% (depending on the contribution structure being used) (taking into account the 1% tax relief).

Existing personal pension schemes are likely to satisfy the first two criteria but employers will need to ensure that arrangements are made to satisfy the third and fourth criteria.

Defined benefit schemes

Where employers operate defined benefit occupational pension schemes, the scheme must either:

(a) be contracted-out of the Second State Pension and satisfy the reference scheme test; or

(b) provide pensions that are broadly equivalent to, or better than, the pensions that would be paid under a "test scheme standard" which requires that the scheme provides a pension of at least 1/120 of average qualifying earnings over the last three years of a member's pensionable service multiplied by the member's years of pensionable service.

Most existing final salary defined benefit schemes should satisfy this test. Closed schemes could be reopened to new members, with a new benefit section.

The requirements are modified for other defined benefit schemes, such as cash balance or career average revalued earnings (CARE) schemes. Where CARE schemes are concerned, a scheme will not be a qualifying scheme if, in relation to active members:

(a) there is no provision for revaluation of accrued benefits under the scheme; or

(b) the revaluation rate is less than the lower of the increase in the retail prices index, the increase in the general level of prices in Great Britain[7] or 2.5% (the "minimum revaluation rate"); or

(c) the revaluation rate is wholly or partly discretionary (unless the scheme's funding takes into account the discretionary revaluation and does so on the basis that benefits will be revalued at the minimum revaluation rate or higher and the funding of such revaluation is set out in the scheme's statement of funding principles).

7 The government intends to use the consumer prices index as the indicator of the general level of prices in Great Britain.

Certification

Whichever type of scheme they operate, employers will be able to self-certify at least every 18 months that their scheme complies with the relevant quality requirements. Self-certification is mandatory for employers who intend to rely on one of the three alternative quality requirements for defined contribution schemes.

Where defined benefit schemes are concerned, an actuary will need to give a certificate in relation to any matter involving calculation or which would otherwise usually be carried out by an actuary.

Details of the self-certification process are set out in a combination of regulations and accompanying guidance published by the DWP.

Where the employer has incorrectly self-certified its scheme, the Regulator may treat the certificate as void, may bring forward its expiry date, and may serve a notice requiring the employer to make up the shortfall between the actual contributions paid and those which should have been paid in order to meet the quality requirement.

6. When do the reforms take effect?

Under the government's current proposals, there will be a staggered implementation of the reforms over a period from 1 October 2012 to 1 April 2017, starting with the largest employers and moving to the smallest in stages. Employer size will be ascertained by the Regulator using PAYE data from HMRC based on the number of individuals an employer has in the PAYE scheme on 1 April 2012. Employers with more than one PAYE scheme will be required to enrol those in all of their schemes as soon as their first scheme is subject to the new duties. Employers without PAYE schemes will be required to comply with the automatic enrolment obligations from 1 April 2017.

New employers commencing business between April 2012 and September 2017 will become subject to the automatic enrolment requirements over a period from 1 May 2017 to 1 February 2018, starting with the employers which commenced business between April 2012 and March 2013 and moving to the employers who commenced business between July 2017 and September 2017 in seven stages. Employers commencing business from October 2017 will be required to comply with the automatic enrolment obligations immediately.

A small test group of randomly selected small and "micro" employers has been created to go through implementation ahead of other similar sized firms in order to highlight any issues and teething problems that may arise for smaller employers.

The Regulator will write individually to all employers about 12 months and again three months in advance of the date when the automatic enrolment duties arise (the "Staging Date") to tell them when they need to take action and what they need to do to comply. Some employers may wish to bring forward their Staging Date if it is helpful to do so, for example, to align with administration processes. The alternative date must be selected from a list of available Staging Dates and may not be earlier than October 2012.

Employers should consider whether they would like to take up this option. This may be particularly relevant for large groups comprising several employers who may have different Staging Dates.

7. Transitional arrangements

Employers will experience transitional periods of different lengths depending on their Staging Date.

Defined contribution schemes

The minimum contribution requirements for defined contribution schemes will be phased in over two transitional periods in order to help employers and individuals adjust to the additional costs gradually. It is proposed that employers and jobholders will be required to pay contributions as follows[8]:

Transitional periods	Employer contribution (of qualifying earnings)	Total contribution (of qualifying earnings)*
From July 2012	1%	2%
From October 2017	2%	5%
From October 2018 onwards	3%	8%

* including tax relief

Defined benefit and hybrid schemes

The Government will allow employers sponsoring qualifying defined benefit and hybrid schemes to choose to delay automatic enrolment for a transitional period of up to five years, as long as they give notice to their jobholders (in accordance with legislation) that they intend to defer automatic enrolment. However, certain jobholders[9] will be able to opt into the employer's qualifying defined benefit/hybrid scheme at any point during this transitional period. The transitional period for defined benefit and hybrid schemes will end on 30 September 2017 irrespective of the employer's Staging Date.

Employers who close their defined benefit scheme during the transitional period must automatically enrol employees into an alternative qualifying scheme. Where that alternative is a defined contribution scheme they will need to pay employer contributions with effect from the jobholder's original automatic enrolment date (see 8 "How does automatic enrolment work?" below) (which could amount to five years' worth of contributions).

8. How does automatic enrolment work?

Employers must automatically enrol eligible jobholders into an automatic enrolment scheme unless the jobholder is already a member of a qualifying scheme. An individual who does not wish to participate has the right to opt out.

8 Different contribution levels will apply if the employer is proposing to self-certify on the basis that their scheme satifies the "threshold 1" quality requirement.

9 Existing eligible jobholders at the original Staging Date who were previously entitled to join a qualifying DB/hybrid scheme and remain able to do so.

The employer must ensure that, within one month of the automatic enrolment date, the jobholder becomes an active member with effect from the automatic enrolment date. This date will be the earliest of:

(a) the employer's Staging Date, for all existing employees over 21 who have qualifying earnings;

(b) when an employee starts work, for all new employees aged over 21 who have qualifying earnings;

(c) when an employee reaches 22, where he or she has qualifying earnings; or

(d) when an employee first has qualifying earnings, where he or she is over 21.

Re-enrolment

Employers have a duty to re-enrol eligible jobholders once every three years for those members who have opted-out. Employers will have a six month window which runs from three months before to three months after a jobholder's re-enrolment date in which to re-enrol them. However, where a jobholder opts out within 12 months of the re-enrolment date there will be no requirement to re-enrol that jobholder until the next three year anniversary.

Given the significance of the Staging Date for re-enrolment obligations, employers may want to bring forward the Staging Date to align this with administration processes – see 6 above "When do the reforms take effect?".

The employer must give certain prescribed enrolment information (set out in regulations) to the jobholder and certain prescribed jobholder information (also set out in regulations) to the trustees/scheme provider within a prescribed timeframe.

Opting out

Automatic enrolment itself is compulsory but once automatically enrolled, a jobholder has one month from becoming an active member to give the employer a valid opt out notice. Upon opting out, any contributions deducted from the jobholder's qualifying earnings must be refunded. The duty to provide refunds lies with the employer (and not the scheme), and there are prescribed timeframes for repayment.

The regulations contain a deliberately prescriptive method by which a jobholder can opt out. For example:

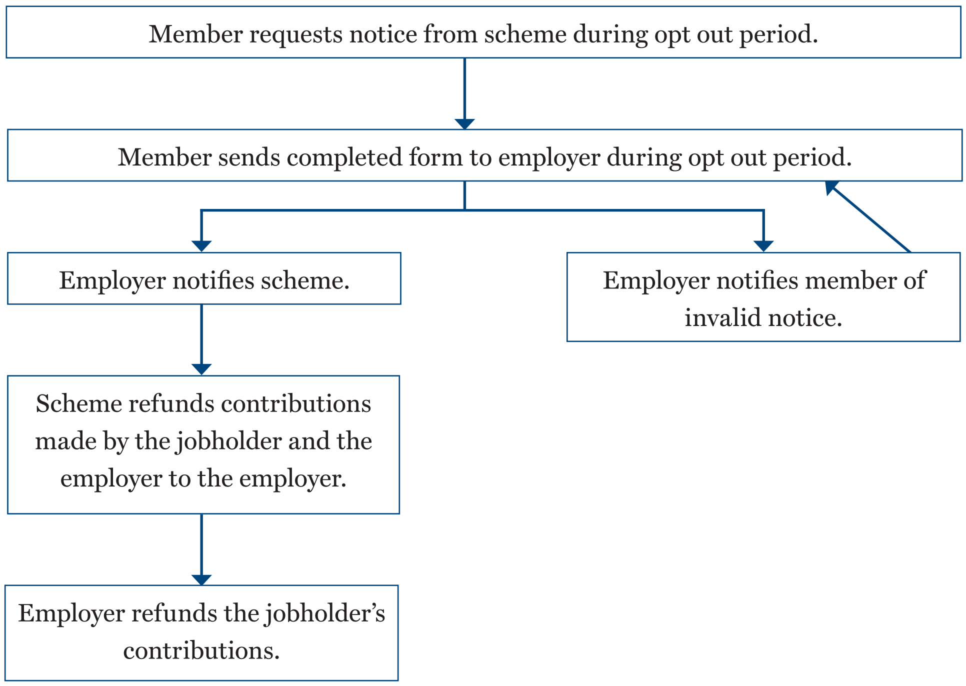
(a) the opt out notice is only valid if it is in the form prescribed by the regulations;

(b) a jobholder must approach the scheme directly for an opt out notice, not the employer (except where the jobholder is an active member of an occupational pension scheme and that scheme has, in its trust instrument, expressly delegated all its administrative functions to the employer);

(c) the opt out notice must be signed by the jobholder and contain certain prescribed wording; and

(d) the notice must be returned to the employer and not the scheme or provider.

The opt out process can be illustrated as follows:



Waiting periods

The automatic enrolment requirements have been relaxed by the introduction of what is known as a 'waiting period' by the Pensions Act 2011.

This allows employers to delay an eligible jobholder's automatic enrolment date by giving them notice that they intend to defer the date. A waiting period of up to three months after the jobholder's original automatic enrolment date is allowed. The jobholder can however choose to opt into automatic enrolment during the waiting period.

9. How will the new national scheme, NEST, work?

NEST is an alternative to an employer's own scheme. It has been established under trust as a registered pension scheme. It is a multi-employer scheme and will have a huge number of participating employers. The trustee, a trust corporation named NEST Corporation, has a statutory obligation to accept any employer that wishes to use the scheme to fulfil its statutory duties.

Large parts of existing pension legislation apply to the scheme and trustee, subject to some modifications.

For example, the scheme will not have to appoint member-nominated trustees or consult with employers on changes to its statement of investment principles (but see below on the appointment of a members' and employers' panel).

NEST is governed by a scheme "order and rules".

The main features of NEST are as follows:

(a) The annual contribution limit (the maximum amount of contributions which may be made by, or on behalf or in respect of, a member of the scheme in a tax year) is £3,600 (based on the average earnings index for December 2005, and to be adjusted by the trustee in accordance with changes in the average earnings index; for 2012/13 the annual contribution limit is £4,400).

(b) There will be no differentiation between active and deferred members. All members will be able to make contributions until they draw benefits.

(c) Self-employed workers will be able to participate in the scheme as individual members.

(d) A members' and employers' panel will be established to allow the trustee to engage with the diverse membership and employers. The employers' panel will have to be consulted on changes to the scheme's statement of investment principles.

(e) Benefits are drawn by way of a lifetime annuity and tax free cash sum at any age between 55 (or earlier, where the member is suffering ill-health) and 75.

(f) Lump sum death benefits are payable in accordance with a member's expression of wish form.

(g) There will be one or more default funds for members that do not wish to make active investment decisions.

(h) There will be a ban on transfers in/out of NEST[10].

A key aim of the scheme is to have low management charges and costs. Charges will be consistently applied to all members irrespective of their age or earnings.

10. Enforcement

Employers will not be able to offer inducements to jobholders to opt out, nor will they be able to ask job applicants at interview whether they plan to do so.

If a jobholder suffers any detriment because his or her employer breaches the regime, he or she will be able to claim in the employment tribunal.

Employers will be required to register their compliance by providing information about how they have met the automatic enrolment duties to the Pensions Regulator. Employers must register within four months of their Staging Date and that, in order for the Regulator to have an up-to-date set of employer information, employers will be required to re-register every three years within one month of the re-enrolment date.

10 Except in certain circumstances prescribed by legislation. This ban will be reviewed in 2017.

In addition, employers and trustees will be required to keep records relating to the pension arrangements they have made, the enrolment of jobholders, the opt out process, the opt in process for voluntary savers and the contributions made.

The Regulator will be charged with ensuring that employers comply with their new obligations. It will be able to issue a range of compliance notices and penalties, including a flat-rate fixed penalty of £400 as a "wake-up call" to employers who have not responded to earlier warnings.

Where an employer breaches specific statutory duties, such as failing to comply with the basic statutory duty to enrol jobholders automatically, officers of the employing company are liable to a statutory fine or, in serious cases, for imprisonment for a term not exceeding two years.

The Regulator has published strategy and policy documents on compliance and enforcement, together with a summary document, all of which are available on the Regulator's website.

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