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KEY GUIDE

Workplace pensions and auto-enrolment

Nudge, nudge…

Automatic enrolment has 'changed the UK workplace forever,' according to the National Association of Pension Funds (October 2013). The Department for Work and Pensions (DWP) estimates that the new rules 'could almost double private pension income by the time people now starting work reach their retirement.' No employer – however small – can afford to ignore these changes.

The first phase of a radical set of pension reforms got underway in October 2012 and employers will be coming into the scheme over the following six years.

The automatic enrolment of employees and certain other workers into workplace pension schemes draws on 'nudge theory' – the notion that individuals can be nudged into taking beneficial actions that they might otherwise avoid, such as joining and contributing to a pension plan. Millions who might never have got round to applying for a pension are expected to save in schemes organised by their employer.

Alongside automatic enrolment, the government is legislating for the introduction of a single-tier state pension of about £150 a week to replace both the basic state pension and the state second pension (S2P) from April 2016. This will reduce the risk that individuals could be better off opting out of auto enrolment and relying on means-tested benefits. The government is also planning to introduce automatic transfer to a new employer's pension scheme when those with small pension pots move job.

Focus point

Auto enrolment began in 2012 and employers will be coming into the scheme over the following six years.

For employers, automatic enrolment brings extra cost and administration. For the first time, employers will be obliged to pay into pensions unless employees opt out. If you already provide a pension, the number of members is likely to increase. There will be extra administration, involving communicating with staff, dealing with pension providers and satisfying the Pensions Regulator that you are meeting the requirements.

The process of introducing automatic enrolment into an organisation is not something that can be left to the last minute.

Auto enrolment – the basics

The easiest way to understand auto enrolment is to work through a few simple questions.

Who is affected?

Almost all employers are affected. The main exception is a company with only a single employee who is also a director. The range of employers affected therefore runs from multi-national companies to a family who employs a nanny.

The change also affects all 'workers' between age 16 and age 74 who work, or usually work, in the UK. 'Workers' includes employees and others who are contracted to work for you, except as part of their own business. Agency workers are included, and you are likely to be responsible if you pay them directly.

Workers will be 'eligible jobholders' if they:

- are aged 22 or over;
- are under state pension age (a moving target, these days); and
- earn more than a minimum income, which is £10,000 a year in tax years 2014/15 and 2015/16.

Eligible jobholders must be automatically enrolled into a suitable pension scheme unless they are members of an existing qualifying scheme. You cannot assume that a current scheme will necessarily be suitable for automatic enrolment, because it may not meet the requirements for payment levels and charges or include an appropriate agreement with the pension provider.

There is a second group of workers known as 'non-eligible jobholders.' They are workers who:

- earn more than £5,772 a year in 2014/15 (£5,824 in 2015/16); and
- are not eligible jobholders.

Non-eligible jobholders must be offered a pension on the same basis as eligible jobholders, but they must apply to join rather than being automatically enrolled.

The final group is of those over age 16 who earn less than the minimum for non-eligible jobholders, and who are known as 'entitled workers.' You have to offer them access to a pension scheme, but you do not have to pay into it.

Focus point

The Pensions Regulator recommends that you start planning for automatic enrolment 12 to 18 months before your staging date.

When must you act?

Every employer has a 'staging date' between 1 October 2012 and 1 February 2018. Your date is determined by the size of your PAYE scheme at 1 April 2012, your PAYE reference number or, for businesses started since 1 April 2012, when you first paid PAYE income. By October 2014, all employers with a PAYE scheme membership of at least 60 were required to be operating auto enrolment. Those with at least 50 staff are brought in by 1 April 2015, with smaller companies starting from June 2015.

In theory there is nothing to prevent an employer beginning auto enrolment earlier than its official staging date, although in practice it is hard to see why it would, given that it would bring forward the need to make contributions. There is also an option to defer automatic enrolment for up to three months after the staging date, but employees can opt in during that period.

After the staging date, employees who become eligible jobholders must be automatically enrolled, although the employer can defer enrolment for up to three months. And every three years an employer must automatically re-enrol those who have chosen to opt out.

Because there is a significant amount of effort involved in assessing the workforce and ensuring that appropriate pension arrangements are in place, the Pensions Regulator recommends that you start planning for automatic enrolment 12 months before your staging date.

How much must you pay?

Auto enrolment requires a minimum overall level of pension contribution to be made for eligible jobholders as a percentage of their qualifying earnings. These include overtime, commission and bonuses and several statutory payments. In 2014/15 this covers a band between £5,772 (the national insurance contributions (NICs) lower earnings limit) and £41,865 (the NICs upper earnings limit). The thresholds are reviewed each tax year and increase to £5,824 and £42,385 for 2015/16.

There is a minimum employer contribution and a minimum overall contribution, both of which are being phased in as follows:

Period	Minimum employer contribution % of qualifying earnings	Minimum total contribution % of qualifying earnings
1/10/2012 – 30/9/2017	1	2
1/10/2017 – 30/9/2018	2	5
1/10/2018 onwards	3	8

The minimum total contribution includes basic rate tax relief (currently at 20%) on any employee contribution. So where the employer pays the minimum required from October 2018, and assuming tax relief is unchanged, the minimum overall contribution will be split as follows:

Contribution based on 'qualifying earnings'	%	Based on £25,000 earnings and 2014/15 limits
Employer minimum	3	£576.84
Employee net	4	£769.12
Tax relief on employee contribution	1	£192.28
Total	***8***	***£1,538.24***

Focus point

Auto enrolment requires a minimum overall level of pension contribution to be made for eligible jobholders as a percentage of their 'qualifying earnings.'

Many employers are happy to pay in more than the minimum as an additional benefit for staff. They may also want the cost of their pension payments to be the same each month, rather than to fluctuate with overtime, commission etc. To allow this, the employer can certify that contributions meet one of three alternative contribution bases. For example, contributions from October 2018 can be at least 9% of basic pay, with at least 4% paid by the employer. This is more likely to allow existing schemes to continue unchanged. Under the alternative bases, almost all staff will receive contributions at least as high as under the standard basis.

The setting of contribution rates is one of the most important decisions you have to make as an employer. Paying more than you have to obviously comes at a cost to both employer and employees, but experts agree that the minimum contribution level is not nearly enough to provide a satisfactory retirement income, even after adding in the value of the new state pensions. One option to incentivise staff might be to set a minimum contribution level, but offer to pay in, say, an extra 0.5% of salary for every 1% individuals choose to pay on top of this, up to an overall maximum amount. Or you could consider a contribution level that increases gradually over time.

There are potential financial penalties of up to £10,000 a day for employers who fail to implement auto enrolment. There are also other penalties for those who encourage employees to opt out, for example by recruiting only those who agree to opt out immediately once their employment begins.

Which pension scheme?

Each employer must have one or more 'qualifying' pension schemes. A qualifying scheme must include a formal agreement that the employer will pay at least the minimum contributions, including passing on any from the employees. In addition, employees who are automatically enrolled must not be required to make any decisions, which means there must be a suitable default investment option, and from April 2015 there is a maximum charge for members equivalent to 0.75% of the value each year.

There are many ways to meet the requirements, including:

- a new in-house scheme, designed to meet the new rules;
- an existing in-house scheme, although this may change to satisfy the regulations;
- a group personal pension (GPP) under a contractual arrangement with an insurance company or other product provider;
- a master trust scheme, covering the employees of a number of employers.

In-house schemes can be tailored to the requirements of the company and its staff, but they require considerable administration, such as appointing trustees and maintaining records. They are now mainly set up by large companies or they are used in order to provide highly flexible pensions for high-earning directors and employees of smaller companies. Most companies choose a scheme run by a pension provider, which deals with most of the administration.

Focus point

Each employer must have one or more 'qualifying' pension schemes.

GPPs are generally run by large insurance companies and offer a wide range of investment options as well as support in setting up and communicating your pension arrangements, generally with the help of a financial adviser. Although you make the arrangements, each employee has their own contract with the provider and can continue paying in if they leave your company.

Master trusts are similar to in-house schemes, but cover many companies and are administered centrally. Some master trusts have been set up specially to provide a simple, low-cost option for automatic enrolment. These include the National Employment Savings Trust (NEST), which was established by the government to ensure that every employer has access to at least one pension scheme. Key features of NEST are:

- NEST is run by a **non-departmental public body**, the NEST Corporation, and the scheme's set-up costs were funded by a loan from the DWP that is to be repaid from future NEST charges. NEST is not a government pension scheme, although the government does appoint the chairman and other trustee members of NEST Corporation.

Focus point

Complying with your auto enrolment obligations is a complex process, and it is important that you develop an action plan.

- NEST is a **master trust occupational pension scheme** that is obliged to accept any employer wishing to use it to meet their auto enrolment requirements.The scheme has the same low charges for all members – 1.8% of each contribution and an annual management charge of 0.3% of each member's fund. By default, contributions are allocated to a 'target date fund' based on the year when the member is due to reach state pension age. This is designed to manage investment risk and to reduce the likelihood of losses when members are starting out or are nearing retirement. However, there is the option to invest in any of five other funds or select a different target date. There is an overall contribution limit of £4,600 per member in 2014/15, and no transfers into or out of NEST are generally allowed. These restrictions will be removed by 2017.
- NEST offers **a simple, low-cost option for employers,** but it is not a default for automatic enrolment. GPP charges are often based on an employer's particular characteristics, such as number of employees, average earnings and staff turnover. This means that charges can be comparable to, or even lower than, NEST and can also provide added value features. Some of the other master trust schemes offer different investment options, while individual company schemes give an employer and staff more control over their scheme and its features.

A combination of different schemes may be appropriate for some employers. For example, it might be appropriate to enrol junior staff into NEST or a similar master trust scheme, while more senior employees could be rolled into a GPP. Another possible approach would be to use a master trust for the majority of staff and a small self-administered scheme (SSAS) for directors.

What do you need to do?

Complying with your auto enrolment obligations is a complex process, and it is important that you develop an action plan. Things you must do include:

- Find out your organisation's staging date.
- Assess your workforce, so that you know how many fall into each category and can estimate the cost of auto enrolment.
- Review any pension arrangements you have and consider how you can best meet the automatic enrolment requirement.
- Consider any changes you need to make to your payroll processes.
- Communicate with your staff and arrange auto enrolment. This will include processes for managing opt-outs and refunding any contributions these employees have made. If you take advantage of the ability to defer for three months you will save money, but there will be extra administration.
- Register with the Pensions Regulator and ensure that you keep the necessary records.

There is then the ongoing process of ensuring that you auto-enrol all employees as they become eligible and repeating the process every three years for any who have opted out.

How we can help

Auto enrolment imposes new duties and, probably, additional costs on your business. There are many decisions to be made and potential pitfalls at every stage. The Pensions Regulator has produced detailed guidance and pension providers can help to some extent, but many companies value the expertise of an adviser who can look at their particular circumstances and recommend solutions.

We make it our business to stay up-to-date with the latest developments in auto enrolment so that we can offer you the very best in expert advice.

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