ST. JAMES'S PLACE
WEALTH MANAGEMENT

EMPLOYER NEWS

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PENSION REFORM

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INTRODUCTION

Of all the big pension news stories of recent years, the most understated is the implementation of the auto enrolment rules. Yet these rules could also have the greatest impact of anything we have seen in the last 25 years.

All the signs are that we are heading for a late life crisis with many more retired claimants and fewer employed contributors to the National Insurance Fund. We are living longer and political and economic imperatives are forcing down real expenditure on State benefits. So, the main political parties are agreed on an employer-centric solution and a reduction in the dependency on the State pension scheme.

Auto enrolment is the latest attempt by Government to reinvigorate pension saving in this country. It is a recognition that the solution lies in private provision,but that encouragement and nudging are not enough.

WHAT IS AUTO ENROLMENT?

Auto enrolment is an obligation on all employers to enrol eligible jobholders in a workplace pension scheme unless they are already a member of a Qualifying Scheme.

An auto enrolment scheme is a Qualifying Scheme that must meet a further set of conditions. The scheme may be a defined benefit scheme or a defined contribution scheme. It must be a UK registered pension scheme for tax purposes or a qualifying overseas pension scheme.

In the UK, the scheme must be a direct payment scheme (the requirement of a 'workplace pension scheme'). This simply means that contributions must be collected and paid to the scheme by the employer through the payroll system.

Far reaching criteria

The auto enrolment criteria are perhaps more far reaching than you might think. Simply put, the scheme must include no provision that could be a barrier to auto enrolment or re-enrolment and it must not require the member to make a decision or provide information as a condition of active membership.

There is a requirement to include a 'default fund' under a defined contribution scheme so that the jobholder does not have to choose a fund before joining the scheme. The default investment fund must have total charges of no more than 0.75% a year. If the employer is suggesting the scheme is established under a salary sacrifice arrangement, an alternative payment method must be offered so that this does not become a barrier to entry.

To meet the minimum requirements of a Qualifying Scheme, it must meet minimum contribution requirements (defined contribution schemes) or a qualitative test of benefits (salary related or defined benefit schemes).

WHO IS AN 'ELIGIBLE WORKER'?

The starting point is that nearly all UK 'jobholders', including someone who would otherwise be self employed with an employer, who are not already members of a Qualifying Scheme are eligible and must be auto enrolled.

- *The employer can choose not to enrol workers if they are under the age of 22 or over State Pension Age.*
- *Individuals below the age of 22 or between State Pension Age and 74 can ask to be admitted, in which case the employer must contribute if the individual's earnings are £5,876pa or more. (2017/18).*
- *If a worker earning less than this asks to join, the employer is not obliged to contribute.*
- *The employer may also exclude workers earning less than an earnings trigger in each pay reference period.*
- *Depending on the structure of pay reference periods, the earnings trigger will be £192 if workers are paid weekly, £833 monthly and £10,000 annually for 2017/18.*

A controlling director of a limited company with no other workers does not have to be auto enrolled and even if there are other workers an employer can choose not to enrol directors. Where the employer is a partnership or a self employed individual, the equity partners and the proprietor will not need to be auto enrolled but other workers will need to be. The responsibility for auto enrolment for agency/temporary staff rests with the party that actually employs them ie the organisation responsible for physically paying the worker. Contractors may have to be auto enrolled, depending on the nature of their contract with the employer.

Even if the employer is based overseas, the auto enrolment legislation will apply to all workers who are working or ordinarily working in the UK.

The employer will need to check whether a worker has become eligible for auto enrolment at their staging date and at every pay reference period thereafter (eg weekly, monthly, fortnightly).

The employer may operate 'Postponement' (a 'waiting period' of up to three months) although the member may choose to join in that period.

For clarification on specific employee circumstances, The Pension Regulator can assist on 0345 600 1011.

THE MINIMUM REQUIREMENTS OF A QUALIFYING SCHEME

The employer must be satisfied that the nominated scheme is a Qualifying Scheme.

The minimum requirements of a Qualifying Scheme (and therefore an auto enrolment scheme) currently relate to benchmarks for minimum contributions (money purchase schemes including personal pension schemes) and for benefits (defined benefit schemes).

There are special rules for career average schemes and hybrid schemes (combination of defined benefit and defined contribution benefits).

Defined contribution schemes

For defined contribution schemes, the scheme must satisfy a minimum contribution test. The minimum required contribution is based on a band of earnings falling between £5,876 and £45,000pa in 2017/18.

The regime has started with a combination of 'staging' and 'phasing'. Staging refers to the obligation applying to employers from different dates depending on the number of people on payroll on 1 April 2012 and PAYE reference number.

The largest companies (over 120,000 workers) had to implement the new rules from October 2012. Businesses with less than 30 workers will be required to comply between 2015 to 2017. New businesses established after 2012 will have to comply by 2017/18.

'Phasing' refers to a progressive increase in the required contribution from 2012 to 2019. Based on an ultimate contribution of 8% of qualifying earnings, the schedule for minimum contributions is as follows:

	Employer minimum	Total minimum contribution
To Mar 2018	1%	2% (including 1% worker contribution)
Apr 2018 to Mar 2019	2%	5% (including 3% worker contribution)
From April 2019	3%	8% (including 5% worker contribution)

The employer has three other options that they can consider, depending on the definition of earnings used. They are referred to as 'Sets'.

Set 1: requires a contribution of at least 9% of the worker's pensionable pay. This includes an employer contribution of at least 4%.

Set 2: requires a contribution of 8% of pensionable pay (this includes at least 3% from the employer) provided that the total pensionable earnings of all relevant workers to whom the Set relates adds up to 85% of their total remuneration.

Set 3: requires a contribution of at least 7% of the worker's total remuneration (at least 3% employer contribution) ie, all earnings must be pensionable.

The schedule for Sets earnings is as follows:

	To Mar 2018	Apr 2018 to Mar 2019	From Apr 2019	Pensionable Pay Definition
Set 1	2% Employer 3% Total	3% Employer 6% Total	4% Employer 9% Total	Scheme Definition
Set 2	1% Employer 2% Total	2% Employer 5% Total	3% Employer 8% Total	Scheme Definition but equal to 85% of Total Pay (scheme average)
Set 3	1% Employer 2% Total	2% Employer 5% Total	3% Employer 7% Total	100% of Total Pay

There are deadlines for allocating contributions, as indeed there are at the moment, whereby they must be paid by an employer to the scheme provider by the 19th of the month following deduction eg contributions deducted via payroll on the 25 January would have to be with the scheme by 19 February.

If the employer has an existing pension scheme, it will have to meet the minimum contribution limits detailed above in order for this to be a Qualifying Scheme.

Where the only existing scheme is a stakeholder 'empty box', this scheme will not meet the auto enrolment obligations. At the very least the employer will need to start contributing and the employer will need to ensure that the existing provider will allow auto enrolment.

If the existing scheme is currently a 'contribution matching scheme' whereby the employer will contribute a certain amount providing the employee also contributes that amount, it may be a Qualifying Scheme, provided that the minimum contribution requirement amounts are met.

There may be instances where a worker cannot afford to pay the full amount of their required contribution and so decides to opt out of the scheme. In these instances the employer may be willing to allow them to join/remain in the scheme on a reduced personal contribution level. However, as these workers do not meet the minimum requirements for auto enrolment, the employer will have to re-enrol them every third anniversary of the employer's staging date.

It is possible to use 'salary sacrifice' to make contributions to the scheme, but the use of 'salary sacrifice' cannot be a barrier to stop workers being able to join the scheme. Care should be taken that an employees salary does not fall below the National Living Wage.

The contracts of employment for existing staff may need to be altered to reflect the fact that salary sacrifice will be the method of personal contributions to the scheme. As salary sacrifice cannot be made compulsory, there may need to be a separate category in the scheme for those workers who do not wish to use salary sacrifice.

Defined benefit schemes

For a defined benefit scheme, there will be a qualitative test resembling the reference scheme test for contracted-out defined benefit schemes. The benchmark will be known as a 'test scheme' and for the scheme to be qualifying, it must be broadly equivalent to or better than the test scheme. If the scheme is contracted-out, it will meet the standard.

The features of the test scheme (important if the employer's scheme is not contracted-out) are:

- *The scheme must offer a lifetime pension from age 65 or later State Pension Age;*
- *The accrual rate must be at least 1/120th and must be applied to earnings averaged over the last three tax years before the end of pensionable service;*
- *The scheme must meet the revaluation requirements for early leavers (ie the benefits increase with the CPI capped at 2.5%);*
- *The pension in payment must increase with the CPI capped at 2.5% or 5% (depending on start date).*

There are special rules to ensure that a career average scheme is adequately revalued, but the basis will depend on the design of the scheme.

COMMUNICATION WITH WORKERS

Communication is an essential step in preparing for auto enrolment and employers are required to provide, in writing, the right information, to the right individual, at the right time.

The precise employer duties will be based on the ages and earnings of workers at the staging date, so it's important to know workers' ages and gross earnings.

An employer has six weeks from their staging date during which they must write to all workers telling them about their rights and what auto enrolment means for them (or that auto enrolment has been postponed).

This needs to be done when a worker becomes eligible for auto enrolment for the first time (see Who is an 'eligible worker' earlier in this document), or when any new worker joins the business.

The scheme provider will write to workers who have been auto enrolled providing details of the scheme. If the workplace pension scheme is a personal pension scheme, employers must make sure that the provider has sent the scheme's 'Terms and Conditions to each worker who is to be automatically enrolled. This is a vital part of the process as it sets up the contract between the provider and the worker. Without it, an employer will not have fulfilled their duties.

Pension Regulator templates

The Pension Regulator has developed a set of letters which include all the details employers are required to communicate with their workers. There are several versions available and the letters can be adapted to suit the employer and workers' circumstances. The templates can be found on the Pensions Regulator's website: www.thepensionsregulator.gov.uk/writing-to-your-clients-staff.aspx

Where an eligible worker chooses to opt out of the auto enrolment scheme, then they have to be written to and re-enrolled on every third anniversary of the employer's staging date.

OPTING OUT

The employer must enrol any jobholder who is eligible and not a member of a Qualifying Scheme from the staging date or the date the jobholder joins the employer (whichever is later), or on the third anniversary of the previous auto enrolment exercise, if the jobholder had previously opted out of the scheme.

A fundamental principle is that the jobholder must first be enrolled and achieve active membership, and will then be able to opt out. The success of the proposals will be largely attributable to inertia: jobholders not getting around to opting out. Employers will be banned from incentivising optouts.

Those individuals who have been granted Enhanced Protection from the Lifetime Allowance charge under the 2006 'A' Day reforms or have been granted any form of Fixed Protection must opt out within one month of being enrolled, and subsequently every three years when they are re-enrolled, if they are to avoid losing that protection. However, where an employer 'has reasonable grounds to believe the worker is protected from tax charges on their pension savings' (under HMRC's primary, enhanced or fixed protection requirements) regulations allow them to choose to exclude a worker from the automatic enrolment process.

To make the auto enrolment process more administration-friendly, the DWP introduced the following amendment to the original rules:

- *The auto re-enrolment dates will be between three months before and three months after each third anniversary of the employer's staging date.*

REPORTING

The employer will be required to complete a Declaration of Compliance for their auto enrolment scheme of which workers are members with The Pensions Regulator.

The Declaration of Compliance can only be made online, must be completed within five months of the employer's staging date and will have to be updated every three years thereafter.

If the definition of Qualifying Earnings is being used, then there is no need to certify earnings. If one of the definitions of Set Earnings is used, then at the staging date and every eighteen months thereafter, the employer needs to certify that the minimum contributions for their set are being met.

Employers will be given guidelines on the requirements for self certification by The Pensions Regulator.

The Pensions Regulator will have the ability to impose penalty notices if an employer does not comply with their new duties. These can be:

- A fixed penalty of £400 where an employer fails to respond to a warning notice.
- An escalating penalty of £50 to £10,000 a day (depending on the size of the employer). An example could be where an employer does not pay contributions on time.
- A fixed penalty of £1,000 to £5,000 for prohibited recruitment conduct, for example if an employer screens job applicants for their intention to join the pension scheme.

IS IT SAFE FOR EMPLOYERS TO GIVE ADVICE?

It would be inappropriate to complete a summary of such a momentous change for employers without mentioning the requirements and restrictions of the Financial Services Act as it applies to employers. Broadly speaking:

- *The employer may invite an adviser to present to staff;*
- *There is no problem with giving the staff information;*
- *No recommendation or advice can be given;*
- *There is no problem with the employer explaining why a worker should join a scheme to which the employer contributes;*
- *The employer must inform the worker that advice is available from a financial adviser;*
- *The employer should take no financial reward for establishing a scheme.*

THE EMPLOYER'S STRATEGY

An employer has much to think about with much preparatory work to be considered, even if the employer already offers a pension scheme.

Given that there are requirements to register processes and schemes with The Pensions Regulator, a proper strategy is essential. Most large scheme advisers have recommended that the planning should already have started. The project may require an accountable manager and team.

The areas to be addressed are:

- *Establish the staging date;*
- *Determine which workers will be eligible;*
- *Choose a Qualifying Scheme;*
- *If an existing scheme is to be the Qualifying Scheme, whether the scheme rules need to be changed. If they are not changed, the employer must ensure that each individual's membership meets the criteria;*
- *Determine whether the employer wishes to exceed the minimum contribution requirements and to what extent;*
- *Determine the basis of contribution (Qualifying Earnings or one of the 'Sets');*
- *Establish the payroll facility;*
- *Determine how the scheme and employer will distribute information;*
- *Consider how the costs of the contributions and administration will impact on the business profits and take this into account when tendering for contracts beyond their staging date.*

The value of a pension will be directly linked to the performance of the funds selected and the value can therefore go down as well as up. You may get back less than you invested.

The levels and bases of taxation and reliefs from taxation can change at any time. The value of any tax relief depends on individual circumstances.

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