Pension Auto-Enrolment

This month's Q View took on a slightly different approach. John Sansone, Director at Berkeley Burke Employee Benefit Consultants, an expert on pension auto-enrolment, attended the discussion to provide an unparalleled insight into the issue of auto-enrolment affecting all employers. The Q View panel this month posed numerous questions to John in order to thoroughly understand the issues, preparations and challenges for employers to consider.

Meet the panel

Toni Robinson
Associate Director

David Barratt
HR & Training Business Partner

Hema Mistry
HR & Training Business Partner

Andrew Baines
HS & Training Business Partner

Ruth Frank
Employment Law Consultant

Manthan Ajit
HR Coordinator

John Sansone
Director at Berkeley Burke

Introduction

As one of the first places to try auto-enrolment, Australia introduced the system in the mid-90s, when their minimum pension contribution was set at 3% from an employer and 3% from an employee.

In more recent times, the country now endures a 9%:9% contribution balance, with the employees having no right to opt out of the scheme.

In the UK, auto-enrolment is now descending the ranks of the SME world, affecting any employer with one employee or more.

The key message experts are attempting to assert is the lack of preparation and readiness employers are showing at this moment in time, which is causing massive problems with regards to the choices or lack of choices other employers have.

What's happening at this point in time concerning auto-enrolment?

"The legislation requiring employers to auto-enrol employees was introduced in October 2012 using a phased approach and starting with the largest employers. The obligations are mandatory for employers, but at this point in time, employees have the choice to opt-out of the pension scheme they have been put into. People need to understand that this is very real, and it will affect all businesses and employers in the UK with one employee or more. It will affect them in very tangible ways, principally around cost, and then around operational admin issues."

What are the key issues right now?

"As there is an increasing number of employers implementing auto-enrolment, employers will find it increasingly difficult to get any help from the right people, unless they really have planned well in advance. When this legislation 'bites', an employer will have to assess all of their employees on payroll against new definitions from the Government, but not just on their staging date, but for every pay reference period after that. So that's every time they pay them, whether that be weekly or monthly, they'll have to go through this assessment process again. This is because people's ages change, their earnings change, they might dip in and out of employment, there may be turnover issues, and so on. Employers simply aren't understanding the time all this will take, and are therefore suffering when they leave it too late."

Ideally, how prepared do employers need to be?

"Ideally, employers should begin preparing at least 12 months before their staging date. Employers will receive a letter 12 months in advance from the Pensions Regulator, so as soon as they receive this, they need to start their project. All of the tactical issues that follow will realistically take at least six months. Even if an employer already has a pension provider, there is no guarantee that the provider will take them on for auto-enrolment purposes. If they are turned down, they are usually forced towards NEST, as this is 'the provider of last resort'."

What is NEST?

"NEST stands for the National Employment Savings Trust, which is a qualifying pension scheme available to all employers. Generally, there is nothing fundamentally wrong with this scheme, but it's not as competitive or attractive as a good private sector type scheme. If employers can't get anything else, it's not unreasonable to use NEST, but it probably wouldn't be your first choice. Again, another reason to prepare well before your staging date."

What are the different types of qualifying pension schemes?

"The two main types are the defined benefit scheme and the defined contribution scheme. The defined benefit scheme is the old traditional kind of scheme which will promise you a certain level of your final pay as your pension, depending on how many years of service you've done. This is a relatively old type of plan, which is now very much in decline. Many are now closed to both new and existing members."

"In the last decade or so, defined contribution has been the most popular method. This is very much an investment account approach, whereby an employer and an employee agree to pay a set percentage of earnings into a pension scheme to be invested for the individual."

Berkeley burke

So what is the qualifying criteria to meet the legislation requirements for a defined benefit scheme?

"Schemes must meet the 'test scheme' standard, that is, the benefit provided must be equivalent to or better than 1/120th of average qualifying earnings in the three years before retirement."

"The general advice is to immediately speak with a pension consultant, or even your own advisor if you have a defined benefit scheme."

What is the qualifying criteria for a defined contribution scheme?

"It's a range of contributions which begin at a low level from the staging date. Typically, it's 1% minimum contribution from an employer and a 1% minimum contribution from an employee. This then builds up to 2% and 3% respectively as of October 2017, and then from 2018 it ascends to 3% and 5% respectively. So the overall requirement from 2018 is 8%, out of which the minimum from an employer has to be 3%. As long as they meet this minimum overall criteria, employers can allocate the split of contributions any way they want."

"The general advice is to immediately speak with a pension consultant, or even your own advisor if you have a defined benefit scheme."

How will employers need to categorise their employees for auto-enrolment purposes?

"There are potentially up to four categories to consider. The first being employees who are already members of a qualifying scheme. The second is Eligible Jobholders, those employees aged between 22 and the State Pension Age (currently 65) earning at least £10,000 a year. These employees must be auto-enrolled into a qualifying scheme."

"The third are Non-Eligible Jobholders, employees aged between 22 and the State Pension Age earning between £5,772 and £10,000 per year. These employees should not be auto-enrolled, but should be given the opportunity to 'opt-in' if they wish. The fourth category being Entitled Workers, who are employees earning below £5,772 per year. These employees are not entitled to be enrolled into a qualifying scheme, but they can ask to join a pension scheme. It is important to note that these thresholds are for the 2014/2015 tax year and should be pro rata'd based on the frequency of the employee's pay i.e. £10,000 a year equates to £833.33 per month or £192.31 per week."

So do employees have any say whether they join the scheme?

"Not about being initially put into the scheme (if they are an Eligible Jobholder). But after they are put in, their decision then is to either stay in the scheme, or to opt-out. They can do this, as long as they make that decision by a prescribed deadline, the current deadline is set at 30 days. If employees miss this deadline, however, they can still leave, just not technically 'opt-out.' It is important to note that employers have a responsibility to trigger the usual auto-enrolment obligations every three years for Eligible Jobholders (even if they have opted out or withdrawn from the scheme, but are still employed)."

"Research has come out from The Pensions Regulator which has shown that bigger employers who have already implemented auto-enrolment, have found on average only about 10% of people are opting out of schemes once they have been auto-enrolled."

When the window passes, how can employees still leave?

"Opting out means that before the aforementioned deadline, an employee can say to their employer, 'I don't want to be in this scheme, I want the money back that you've taken towards contributions,' and they'd be entitled to a refund. If they miss that deadline, they can't get a refund back, but they can just leave the scheme. That money then remains in their pension pot that their employer has set up, and it can't be taken out until the employee is at least 55."

What is meant by qualifying earnings?

"These are the level of earnings upon which minimum pension contributions must be based. The pension contributions are not based on the employee's full earnings. The contributions are only based on earnings between £5,772 and £41,865 in the tax year, but these parameters will change each April. So if somebody's earnings fall between these two numbers, it's these earnings which the contribution percentages are based on to work out the actual amount in pounds. The components of pay to count include basic salary, bonuses, commissions, overtime and some statutory pay."

What does an employer have to do for employees in the Entitled Worker category?

"If an Entitled Worker asks to be put into a scheme, an employer has to offer them a scheme (not necessarily the qualifying scheme) but the employer doesn't have to contribute to that scheme for this category of employee."

What are the penalties for non-compliance?

"Very harsh. They depend on the size of employer and type of penalty, but they could be up to £10,000 a day for non-compliance. The financial amount per day is capped, but the amount of days it can be enforced is not."

"The Pensions Regulator won't go straight to a big fine, though. What they'll do is once they're made aware that an employer isn't complying, the first thing they'll do is talk to them and ask them what's going on. They'll try to find out what's happening first of all. They will question whether a timetable is in place and if the employer in question is actually attempting to achieve compliance."

"So, firstly, they will give some leeway, but then they will issue some enforcement notices telling the employer in question to comply as soon as possible. After this, if the employer is still not co-operating, they'll issue fines."

Does the employer have to notify the employees that they have been auto-enrolled and state an amount that will come out of their wages?

"They won't need to notify the employee of the pounds and pence, but there is a statutory content for the notice and level of detail that has to be given out to everyone who has been auto-enrolled. This will tell them how they have been classified, whether they are eligible or not, and what this means for them including contribution percentage details. It will also explain any options employees may have."

So employers can set their contributions as they wish (as long as they are hitting the minimum standards)?

"Absolutely. It's very important here to spell out that the motivation of the employer will be absolutely crucial. If the employer is all about minimising cost, then they need to consider their tactics very carefully."

"It all comes down to how well they know their employees. For example, in some cases, they have a very low take up rate for their current pension plan because they know their employees can't afford it, so this may influence how they set the contribution design for their qualifying workplace pension scheme for auto-enrolment."

"In that scenario, if you go in with the strong strategy of, "Right, you're paying 4% and we'll pay 4%, and that's it", employees will soon notice and are much more likely to opt-out. So the tactics used by an employer will play a crucial part in determining what their actual extra business costs for auto-enrolment will be."

Is this going to affect individuals' private pensions?

"I think any employee who gives up their chance to receive an employer pension contribution into a qualifying pension scheme is missing a trick for a number of reasons. Firstly, they'll miss out on extra money from their employer, and, secondly, they'll miss out on group buying power and the product terms in their individual policy are likely to be worse than those in an employer's group scheme."

"There are strict anti-inducement penalties which serve to prevent employers from encouraging people to opt-out of the workplace qualifying pension scheme. As such employers will not be able to say to employees 'if you opt-out of the scheme we'll continue paying into your personal pension scheme, or we'll give you a pay rise instead'."

> "If the employer is all about reducing cost, then they need to consider their tactics very carefully."

There could be many people who have salary exchange in place, what are the implications for that?

"They should continue doing it, but they should be careful about how it operates with auto-enrolment. For anyone who's already using salary exchange (also known as salary sacrifice) there's no reason to stop using it. There was a relaxation by HMRC for pension schemes just over a year ago which said as long as you make the rules for the salary exchange work so that the employee can opt out at any time, then it's fine and it can work in harmony with auto-enrolment regulations."

"Going forward, and to simplify the payroll process, employers may wish to consider only offering the salary exchange option to those employees who have not opted-out once they have been auto-enrolled. This avoids having to unscramble payroll deductions on different bases should an Eligible Jobholder who has been auto-enrolled decide to opt-out."

"The key message is to put people in the scheme first, and if they stay after their 30 day opt-out period, then offer them the chance to sign up for salary exchange."

What happens to an employee's pension pot if they were to leave a company?

"When an employee leaves, they'll have their pension pot with their old employer. They'll then go to their new employer where they will be auto-enrolled on their scheme, so then they'll have a new account"

"At this point, they can decide whether to leave their previous pot where it is, or transfer it over."

"They should think carefully about whether to do this though, as there may be technical issues or charges for doing so."

Are there any exceptions concerning an employee's eligibility to be auto-enrolled?

"As it stands, the short answer is 'no'. But the Government, due to lobbying from the pensions industry and other parties, is now looking at whether they will make exceptions in certain cases, for example, for employees who are about to leave or retire."

How is it going to affect the employment market nationally?

"It's impacting already. Employers who were considering giving their employees a pay rise are now unable to do so. It's the same with bonuses. In terms of business planning going forward and budget forecasting, employers are now having a much more pragmatic view and realising they have to do auto-enrolment which will serve as an extra cost, so they're going to have to cut back on a few things."

What is postponement?

"Postponement allows the employer an extra window of time from their staging date in terms of when to assess and then auto-enrol employees. The operational preparations before the staging date still have to be done, as employers still have to have everything in place. As long as all relevant information goes out to all employees at the right time, the employer can put off the assessment and auto-enrolment of Eligible Jobholders for up to three months. As long as they tell people that they are using postponement and informing them that they still have the right to 'opt-in' to the pension scheme before the end of the deferral period."

"As new employees are employed following the staging date the postponement arrangements can continue to apply. As such postponement arrangements could be particularly attractive to employers with employees whose earnings fluctuate around the threshold figures discussed earlier, or to deal with probationary periods, etc."