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Auto-Enrolment and Workplace Pension Reform

Information sheet No. 2 – Financial Implications of Automatic Enrolment

This briefing note builds upon our first information sheet dated August 2011, which gave a detailed summary of the forthcoming automatic enrolment requirements. This information sheet, whilst giving a high-level summary of the requirements, particularly focuses on the financial implications facing UK businesses.

Summary of the Requirements

The new duties will be introduced at employers' "staging dates"; these will be staged over a period of four years starting in October 2012 and beginning with the largest employers.

Employers will need to assess their workforces, including consideration of whether the requirements extend to non-employees, e.g. agency staff and contractors. Workers will need to be categorised as either Eligible Jobholders, Non-Eligible Jobholders or Entitled Workers, and the following table summarises the requirements for each group. Please note that annual earnings amounts are shown but pro-rated amounts will apply for each worker's relevant pay reference period, e.g. monthly amounts for workers paid by reference to calendar months.

Earnings \ Age	16 – 22	22 – State Pension Age	State Pension Age – 75
Under £5,035 pa (no qualifying earnings)		Entitled Worker	
Between £5,035 pa and £7,475 pa		Non-Eligible Jobholder	
Over £7,475 pa (the earnings trigger)	Non-Eligible Jobholder	Eligible Jobholder	Non-Eligible Jobholder

For the purpose of the new duties, pension schemes will be classified as automatic enrolment schemes, qualifying schemes or non-qualifying schemes. Automatic enrolment schemes will generally satisfy the same criteria as qualifying schemes but will additionally need to be open to new joiners and allow them to be auto-enrolled without them providing any information or expressing any choice.

The following table summarises the requirements for those workers who are not already participating in a qualifying pension scheme.

Worker Category	Requirement
Eligible Jobholder	Must be auto-enrolled into an automatic enrolment scheme but can then opt out. Opt outs will need to be periodically re-enrolled.
Non – Eligible Jobholder	Can opt in to an automatic enrolment scheme.
Entitled Worker	Can choose to join a pension scheme. This need not be an automatic enrolment scheme or a qualifying scheme and the employer is not required to contribute.

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Summary of the Requirements (continued)

The minimum requirements for automatic enrolment schemes and qualifying schemes are very generally:

- Defined benefit schemes will need to be either contracted-out of the State Second Pension or be deemed to meet the "test scheme standard";
- Defined contribution schemes will need to meet minimum contribution requirements (see the table below for the minimum requirement options applying from October 2017 - these will be phased in - based on qualifying earnings or alternative pensionable pay definitions); and
- Hybrid schemes will generally be measured according to the dominant defined benefit or defined contribution feature.

Definition of pensionable pay	Minimum employer contribution	Minimum total contribution
Qualifying earnings (£5,035 pa - £33,540 pa)	3%	8%
Basic pay from the first £1	4%	9%
Pensionable pay at least 85% of total pay	3%	8%
Total pay from the first £1	3%	7%

The lower and upper thresholds for qualifying earnings are expressed in 2006/7 terms and expected to be uprated in January 2012. The earnings trigger of £7,475 is expressed in 2011/12 terms and will be uprated annually.

Considerations

When will employers become subject to the new requirements?

The new requirements will apply from the employer's staging date. This will normally be determined based on the number of individuals in the employer's largest PAYE scheme size as at 1 April 2012 (please note this will include any pensioner members paid through the employer's PAYE). Employers with 120,000 employees or more in their largest PAYE scheme will have a staging date of 1 October 2012, whilst employers with fewer than 50 employees in their largest PAYE scheme will have a staging date between 1 March 2014 and 1 February 2016 depending on PAYE reference number. Employers may choose to bring forward their staging date to another set staging date more convenient to the operation of their businesses.

Who are workers for the purpose of the requirements and how are they likely to be categorised?

The workforce should be assessed, with recognition that the requirements can potentially extend to workers who do not have a contract of employment. If there will be Entitled Workers, the employer should consider whether to offer them qualifying or non-qualifying provision, and through which pension arrangement.

How many workers are currently either unpensioned or in non-qualifying pension schemes?

A large part of the direct additional costs will relate to Eligible Jobholders who are currently unpensioned or for whom inadequate provision is being made. Some of these Eligible Jobholders may opt out after being automatically enrolled, and some Non-Eligible Jobholders may opt in. Please note that the additional costs relating to the new duties will not necessarily be driven by the minimum requirements; instead they will depend on the design of the pension schemes used by employers to comply with the new duties.

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Considerations (continued)

Which pension schemes will the employer use to meet the new requirements?	Employers will need to review their existing pension arrangements and consider what role, if any, they will take with regard to the new requirements. For example, a contracted out defined benefit scheme that is closed to new joiners but open to future service benefits may be used as a qualifying scheme for the remaining active members but is unlikely to be re-opened as an automatic enrolment scheme. Defined contribution schemes should be reviewed if their membership is to be substantially increased or contributions changed. Most existing pension schemes will need some degree of change, and the timescales for this should be recognised. Consideration could also be given to whether there is any role for the National Employment Saving Trust (NEST) or NEST-like alternatives. Employers will need to register with the Pensions Regulator (and in some cases also certify) those pension schemes used to comply with the new requirements. Employers may wish to consider any consolidation of existing pension arrangements prior to their staging dates.
If the benefit spend is spread more widely, is the current level of pension provision affordable?	If an employer's benefit spend is to cover a substantially increased proportion of the workforce, consideration will need to be given to the additional costs. In some cases, it may be that continuation of current provision is unaffordable and there may need to be some "levelling-down" of benefits.
Will the employer use postponement or phasing?	Employers will be allowed to postpone an individual's automatic enrolment date by up to three months. This could be useful to align automatic enrolment with payroll but also serves to delay the pension cost. However, Eligible and Non-Eligible Jobholders may immediately opt in if they wish. A longer period of postponement, up to 1 October 2016, is available (subject to conditions) for any defined benefit or hybrid automatic enrolment schemes. Phasing in of the minimum defined contribution requirements can be used to graduate onset of the additional pension costs but consideration would need to be given to how this would interact with current pension provision.
What other sources of additional costs might there be?	These may include (particularly in preparation for the new duties) additional HR/payroll administration, management time and professional adviser costs. Group risk insurances, particularly death in service benefits, are often contingent on pension membership; any substantial increase in pension membership can therefore have cost implications for such benefits.
Are there penalties for non-compliance?	The Pensions Regulator may issue a fixed penalty notice of £400 against any employer who has contravened regulations or failed to do what is required of them. The fixed penalty notice may warn that escalating penalties could become due if non-compliance continues. Where an employer remains non-compliant despite having received warnings the Pensions Regulator may issue an escalating penalty notice requiring them to pay a daily penalty until they become compliant. The amount of the penalty depends on the size of the employer, but could be as much as £10,000 per day for the largest employers.

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Services and further information

We provide a range of services to help employers prepare for their forthcoming auto-enrolment duties, e.g. reviewing existing pension arrangements, consultancy on defined benefit and defined contribution pensions, preparation of communications and project management. If you require assistance, please contact your usual Barnett Waddingham consultant or email autoenrol@barnett-waddingham.co.uk

To access further information and register for updates on the new duties, please visit www.barnett-waddingham.co.uk/auto-enrolment

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