



Pensions Alert

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NEST - Auto-enrolment of Employees into Pension Schemes

What is happening?

All employers operating in the UK will soon be subject to a new duty to enrol eligible employees automatically into a pension scheme and pay a minimum level of contributions in respect of those who are enrolled.

As a general rule, with effect from the day that an employer becomes subject to this new duty, it must ensure that all of its eligible employees are auto-enrolled (for joiners after that date it would be their first day of employment).

However, employers can decide to introduce a waiting period and defer an employee's automatic enrolment date by up to three months. There is a notice procedure to go through to achieve this. Most employers are expected to take advantage of this three-month waiting period as it gives a little more flexibility in terms of probationary periods of three months or less.

When will this new duty apply?

The duty will be introduced in October 2012 for those very large employers. Extensions may be introduced but, as things stand, its implementation is then staggered, for decreasing-sized employers (based on the number of people they employ) through to September 2016, although an employer can voluntarily comply with the new requirements early if it chooses. For example, an employer with between 350 and 499 employees will have to comply with the new duties from 1st January 2014.

The Pensions Regulator will write to all employers around 12 months before the new duties are due to apply to them, but we have attached a table (prepared by the Pensions Regulator) showing how the various staging dates will be staggered.

Who will be eligible?

A lot of detail is contained in the legislation but, in summary and as things currently stand, an employee will be a "jobholder" who must be auto-enrolled if the following three conditions are met:

- The employee works (or normally works) in Great Britain under a contract of employment (this will include temporary workers);
- The employee is aged between 22 and state pension age (although some employees under 22 can also choose to opt-in); and
- The employee earns over the income tax threshold, i.e., £7,475 p/a for 2011/12 (although it is possible for lower earners to opt-in) – earnings are defined to include wages, commission bonuses and overtime, including statutory maternity or paternity or adoption pay, and statutory sick pay.

Opting Out

It will be possible for an employee to opt-out of a pension scheme but, as the legislation currently stands, only once they have been auto-enrolled. They must then be allowed to opt-in again once a year, and be auto-enrolled again every three years.

Approximately every three years, employers will have to automatically re-enrol employees who have previously opted out. Employees can, however, choose to opt-out again.

Employers must not take any action (or fail to take any action) which attempts to induce an employee to opt-out of a pension scheme. For example, there should be no implication that an offer of employment is conditional upon an employee opting out.

What pension arrangements can employers use to satisfy the duty?

Employers can use existing or new pension schemes. These can be defined benefit (“DB”) or defined contribution (money purchase) (“DC”) schemes operating on a trust or contract basis, provided the scheme meets certain qualifying criteria, including being a registered pension scheme with HMRC.

Alternatively, employers may use the central National Employment Savings Trust (“NEST”). NEST is a national trust-based DC pension scheme which will be open to all employers, but which has been designed specifically for low earners and others who are new to pension saving.

What are the qualifying tests for existing or new pension schemes?

DB Schemes

DB schemes must meet the test scheme standard which, in summary, means they must have a normal retirement date of 65, provide accrual at a rate of at least 1/120th of average earnings in the past three years multiplied by service to a maximum of 40 years, and provide revaluation and increases in line with the statutory minimum.

Given these specific funding standards, there are no minimum contribution requirements. In practice, many registered DB schemes will meet the qualifying test. However, certification of this should be sought from the pension scheme actuary.

For DB schemes, transitional arrangements will allow the employer to defer auto-enrolment to 2016 even if the employer’s staging date is earlier (although this is subject to various conditions). However, an eligible employee will be able to opt into his or her employer’s DB scheme during this period if he is eligible for membership.

DC Schemes (including occupational DC schemes or group personal/stakeholder pension schemes)

For DC schemes, the qualifying test depends on contribution levels and on how pensionable salary is calculated.

The total minimum contribution required will be 8 percent of “qualifying earnings” for each eligible employee (specific definitions of “pay” will be taken into account for self-certifying DC schemes – see below). As the legislation stands, “qualifying earnings” is defined as “earnings which are more than £5,035 and not more than £33,540.” The 8 percent consists of:

- 3 percent employer contribution;
- 4 percent employee contribution; and
- 1 percent tax relief.

However, it is the overall level of contributions that matters – employers can contribute in excess of the 3 percent minimum if they wish.

A reduced contribution rate applies for a transitional period. For employers, this is a contribution rate of 1 percent up to September 2016, and 2 percent between October 2016 and September 2017.

Can an employer self-certify in advance that its existing DC pension scheme meets the qualifying tests?

Yes, to simplify the process, employers with an existing DC pension scheme will be able to self-certify in advance that the scheme meets the minimum quality requirements.

This facility was introduced following concerns by industry bodies about the administrative

complexities involved for employers in having to satisfy the quality requirements (most employers with DC schemes calculate pension contributions by reference to “basic salary” rather than “qualifying earnings” as used in the auto-enrolment qualifying test for DC schemes set out above). Employers will be able to certify compliance with the certification requirements if they provide contributions on one of the following bases:

- contributions of at least 9 percent of pensionable pay, including a 4 percent employer contribution;
- contributions of at least 8 percent of pensionable pay, including a 3 percent employer contribution, provided at least 85 percent of the relevant payroll is pensionable; or
- contributions of at least 7 percent of pensionable pay, including a 3 percent employer contribution, provided all the relevant payroll is pensionable.

General Points

- All pension schemes used to satisfy the new employer duties will have to meet certain eligibility criteria and comply with information and record-keeping requirements.
- Employers and trustees cannot make auto-enrolment conditional upon any other action, such as requiring employees to make a particular investment choice when being auto-enrolled.

Are the minimum contributions to NEST the same for existing or new DC Schemes?

Yes, this will be the same, i.e., 8 percent of “qualifying earnings” for each eligible employee.

What if an employer fails to comply with the new duties?

The Pensions Regulator is tasked with enforcing compliance of the new employer duties and can issue substantial penalty notices to employers (which can amount to up to £10,000 per day for employers with 500 or more workers). Wilful failure to comply could also amount to a criminal offence, punishable with a fine, up to two years in prison, or both.

What should employers be doing to prepare for auto-enrolment?

Employers need to recognise that the new obligations will soon apply to them, and work out when they will first be affected. They will also need to start to make schemes for complying with the new duties, and decide which vehicle they will use to do that.

What has this got to do with pension scheme trustees?

The Pension Regulator points out that, although these duties will predominantly apply to employers, trustees will also have a role to play. At this stage, the key points are that trustees should:

- find out when the employer will become subject to the new auto-enrolment requirements;
- discuss auto-enrolment with the scheme’s sponsoring employer to determine if its pension scheme can or will be used to meet the automatic enrolment requirements;
- respond to any queries from the employer with regards to its pension scheme meeting the requirements for existing active members.

Depending on whether an existing pension scheme will be used by the employer in the auto-enrolment regime and how, the follow-up action for trustees could be minimal or quite significant.

Disclaimer

Please note that many of the details in relation to these new pensions 'auto-enrolment' obligations have not yet been finalised and are therefore subject to change.

If you are interested in exploring any of the issues raised in this Alert further, we would be happy to discuss them with you.

Reed Smith LLP

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