

Pensions reform

auto-enrolment and compulsory contributions

The Pension Act 2008 shifted workplace pensions from a voluntary to a compulsory regime. Even though we await further legislation, with the changes due to take effect from 2012, it is time to take action. Accordingly we have summarised the legislation as it stands and included our educated assumptions on the likely new legislation*

* following the "Making automatic enrolment work" review presented to the Department of Work and Pensions on 27th October 2010.

Pension Reform - more changes from 2012

From 2012, the Government is intending to introduce automatic pension enrolment in stages between October 2012 and 2016, starting with the largest employers. This will include compulsory employer and employee contributions to be phased in over three phases, as follows:

Phase	Employer pays (minimum)	Employee pays	Tax relief added
1 (to Oct 2016)	1%	0.8%	0.2%
2 (to Oct 2017)	2%	2.4%	0.6%
3 (full implementation)	3%	4.0%	1.0%

Why?

According to the Department of Work and Pensions (DWP) people are living longer and not saving enough to give them sufficient income in retirement. The DWP estimates that about seven million people are not saving enough for retirement. As such, the objective of auto-enrolment is to encourage employees to make pension savings and puts the onus on employers to both administer and to part fund this.

Who must be Auto-Enrolled?

- workers* who are not already members of a "qualifying" pension scheme
- workers* aged between 22 and the state pension age (although employees over 16 can insist on being enrolled and thus benefit from the employer contribution)
- workers* who earn over £7,475 per annum (or £5,720 if the employee wishes to opt in)

* the word "worker" has been deliberately used as this can mean more than just employees and can include some contractors and/or agency workers

When?

Employees must be auto-enrolled within three months of being eligible, but an employee can insist on being enrolled (and benefit from the employer contribution) at any time during this "waiting period". On the other hand, employees can opt out within 30 days of being auto-enrolled but they must again be auto-enrolled every three years.

What constitutes "earnings" for auto-enrolment compliance purposes?

Unfortunately this is not straightforward as this is basic salary plus commissions, bonuses and overtime on a band of earnings between £7,475 (or £5,720 if the employee wishes to opt in) and £33,540. These upper and lower limits will be updated for 2012.

What is a "qualifying" pension scheme?

This could be your own Company sponsored pension scheme if it meets certain criteria, or the Government's new no frills, low cost pension scheme: NEST (National Employment Savings Trust).

To make your own Company sponsored pension scheme “qualifying” it needs to have the following minimum features:

1. auto-enrolment within three months of an employee being eligible
2. for money purchase, stakeholder and group personal pension plans: minimum total contributions of 8% of all earnings between £7,475 (or £5,720 if the employee wishes to opt in) and £33,540, with at least 3% paid by the Company
3. for contracted-out final salary schemes: a minimum accrual rate of 1/80th of pensionable earnings
4. for money purchase, stakeholder and group personal pension plans: default investment fund

Insofar as 2. above is concerned, you will need to certify that your pension scheme meets the required contributions levels and in order to simplify this it is proposed that any one of the following criteria (based on your current definition of pensionable salary rather than total earnings) should be certified as meeting the requirements:

- a minimum 9% of pensionable salary (including at least a 4% employer contribution), or
- a minimum 8% of pensionable salary (including at least a 3% employer contribution), providing that pensionable salaries constitute at least 85% of your total pay bill, or
- a minimum 7% of pensionable salary (including at least a 3% employer contribution), providing that the total pay bill is pensionable

What is NEST (National Employment Savings Trust)?

NEST is a centralised registered occupational pension scheme established by statute and open to any employer. It is intended as a simple, low cost pension scheme aimed at low to moderate earners.

The key purpose of NEST is to provide a statutory default vehicle for employers who do not have (or do not wish to have) their own qualifying pension scheme in which to auto-enrol their employees. It is a trust-based scheme and will be run by the NEST trustee corporation which has been set up to be independent of the Government.

In the main it will work like other pension schemes but with a number of special rules and restrictions, making it much less flexible than other schemes:

Contributions - there is a cap on yearly contributions which can be made to the scheme for, or by, any employee. The cap was set at £3,600 in 2005, but should be reviewed in line with the increase in average earnings and is likely to be c.£5,000 in 2012.

Investment - like other qualifying pension schemes, NEST will have a default investment fund for members who do not wish to make their own investment choices. For others, the investment choices will be extremely limited.

Transfers-out - employees will not be allowed to transfer pensions out of NEST unless they are in ill-health or have reached the normal minimum pension age.

Transfers-in - at least initially, NEST will not normally accept transfers of pension rights from other pension schemes.

Pension Income - the only option for providing an income from NEST is to buy a lifetime annuity from an insurance company.

Charges - to support making NEST a low cost pension option, there will be a cap on the charges under the scheme. The long-term aim is for an annual management charge of 0.3% to be charged against members funds. However, in the first 20 years or so, this is likely to be 0.5% together with an initial charge of 2% taken from every contribution paid to the scheme.

What should I do next?

Whereas the exact details of the legislation are still to be finalised, the Coalition Government have made it clear they are committed to automatic pension enrolment and to compulsory employer and employee pension contributions. As such, it is recommended you consider the following:

- the profile and needs of your employees - do you have a spread of moderate or higher income employees or employees who would value more choice and control than available under NEST?
- your business profile - are you in a business sector with competition for employees in which case do you want to have your own “qualifying” pension scheme rather than be seen to be doing simply the minimum required by the Government?
- can your existing pension scheme be altered so as to be a “qualifying” pension scheme?
- what changes do you need to make to your existing pension scheme so as to be a “qualifying” pension scheme and will this give rise to an increase in your costs and to those of your employees?
- if there will be an increase in your costs and/or those of your employees, consider phasing the increases in over the next 4 years.
- if you intend to go down the NEST route, consider who will do the monthly pension calculations and factor in any additional costs.
- discuss the above with your Employee Benefit Consultant.

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