

# Pensions Reform 2012



## Q&A Factsheet For Employers

**All Your Questions Answered**

### What is pensions reform?

Pensions reform is a package of both state and private pension changes, expected to be introduced in 2012. The overall aim of the government's pension reform strategy is to get more people saving for retirement. The Pensions Act 2008 is the second phase of these reforms and sets out new duties for employers. It allows for the establishment of the National Employment Savings Trust (NEST), aimed at low to medium earners.

### When will it start?

The new employer responsibilities start from October 2012 and will be staged in over four years (depending on the size of the company). Contribution requirements will be phased in to allow employers and staff to adjust their cash flow to meet these new responsibilities.

### What are the main employer responsibilities from 2012?

You'll have **two** main responsibilities:

- you'll have to automatically enrol all eligible staff into a pension scheme which meets certain criteria, and
- the total minimum contribution must be 8% with you paying at least 3%.

However, if the employee decides they don't want to remain as a member of the scheme, they can opt out within a month. Their contributions will be refunded and you don't have to make any contributions. However, the employee will be auto re-enrolled again every three years to give them an opportunity to rejoin the scheme at a later date.

### How much will employers and staff need to contribute?

You'll be required to pay at least 3% of qualifying earnings for those who don't choose to opt out. You can choose to pay more but the total contributions from employers and employees must be at least 8% of qualifying earnings.

Of this 8%, you must pay at least 3%. If you only pay this minimum amount, the balance will be met by a 4% employee contribution, and 1% tax relief.

### What does this mean if you have an existing pension scheme?

You'll have to auto-enrol all your eligible employees into a qualifying scheme, which can be your own private pension or the new National Employment Savings Trust (NEST). You may decide to have different pension schemes for different employees, but you have to understand and make sure that your existing scheme meets the qualifying criteria.

### Can you use a group personal pension (GPP) and a group self-invested personal pension (GSIPP) as an automatic enrolment scheme?

Yes, contract-based group private personal pensions such as GPPs and GSIPPs can be used to auto-enrol eligible staff, as long as they meet the qualifying criteria.

### What does this mean if I don't have an existing pension scheme?

You'll have to set up a private pension scheme that meets the qualifying criteria or auto-enrol your eligible staff into the National Employment Savings Trust (NEST).

### **Which 'eligible employees' have to be automatically enrolled?**

From 2012, all employees who are at least 22 and under state pension age must be auto-enrolled into a qualifying scheme by their employer.

### **What about staff who are aged at least 16 and under 22 or between state pension age and under 75, and so aren't automatically enrolled into a qualifying scheme?**

You must inform these employees of their entitlement to join a qualifying scheme if they wish to do so and they have qualifying earnings. If any staff choose to join, you'll be required to pay contributions for them at the minimum level.

### **What is automatic enrolment?**

This is a core employer duty under the pensions reform legislation, whereby you'll have to arrange to automatically enrol all eligible staff into a qualifying scheme, unless the employee:

- is already active in a qualifying scheme at the auto-enrolment date, or
- decided to stop their active membership of such a scheme within a certain period before the auto-enrolment date

### **Is automatic enrolment different to how a person joins their employer's scheme now?**

Yes. Currently an employee has to agree, in writing, to join a pension scheme and to have pension contributions deducted from their salary, and often they have to decide where their contributions are invested. With auto-enrolment, they don't need to do anything to become or remain an active member of the scheme so they don't have to sign an application form.

### **Can employees be automatically enrolled into a scheme ahead of 2012?**

Currently, legislation doesn't allow for automatic enrolment into a contract-based scheme such as a group personal pension. But if you want to start enrolling your employees, you can use a 'simplified' joining process, offered by many providers, which reduces the employee's involvement. However, they still need to give consent to having pension deductions taken from their pay.

### **If an employee opts out, do I still have to pay the contribution?**

No. If an employee chooses to opt out of the pension scheme, then you don't have to pay a contribution on their behalf.

### **What do I have to do if people choose to opt out?**

You must make sure that they follow the prescribed opt-out process, which will be set out in regulations. You'll have to stop deducting pension contributions from the employee's salary, notify the scheme, refund any contributions that were paid during the opt-out period and automatically re-enrol the employee every three years.

### **What is inducement?**

It's illegal for employers to encourage employees to opt out or give up active membership of the pension scheme – known as inducement – for example by offering them cash or any other benefit.

### **What is automatic re-enrolment?**

When an eligible employee has opted out at the last enrolment date, or has chosen to stop making contributions or otherwise stopped being an active member of the scheme, the employer will have a duty to automatically re-enrol them, normally every three years, as long as it's not within a 12-month period of the auto re-enrolment date.

### **What are qualifying earnings?**

In a pay reference period of 12 months, qualifying earnings are gross earnings between £5,035 and £33,540 (with proportionate amounts for a period of less than 12 months). These figures are based on 2006 earnings and will be revised in the future. They're expected to be increased for 2012.

'Earnings' include:

- salary or wages
- commission
- bonuses
- overtime payments
- statutory sick pay, statutory maternity pay, ordinary or additional statutory paternity pay and statutory adoption pay
- such other sums as are allowed under regulations

Most private pension schemes won't currently base contributions on all of these earnings.

### **What happens if the scheme doesn't base contributions on all of these earnings?**

Many schemes don't include all the elements of qualifying earnings in pensionable pay, but the overall level of contributions must still be at least as good as the legislative minimum contribution. The Pensions Act 2008 includes the ability for employers to self-certify in advance that their contributions will meet the test for each of their employees. This is called self-certification and its terms are currently under review.

### **What is the minimum contribution requirement?**

Minimum contribution requirements apply for staff whose qualifying scheme is a wholly defined contribution scheme. The Pensions Act 2008 sets the level of minimum contributions for any pay reference period as 8% of qualifying earnings.

Of this 8%, you must pay at least 3%. If you only pay this minimum amount, the balance will be met by a 4% employee contribution, and 1% tax relief.

## I currently pay more than the minimum requirement – what does this mean for me?

You can continue to do so, there's no change.

## Are part-time workers who don't earn the minimum level of qualifying earnings excluded?

The legislation may require you to arrange for them to become a member of a registered pension scheme, but the scheme doesn't have to be a qualifying scheme and you have no obligation to make contributions on their behalf.

## What about temporary, fixed-term, part-time and foreign workers?

A worker is defined as an individual who has entered into or works under a contract of employment or any other contract to do work or perform services personally for the other contracting party. It doesn't matter whether the contract is in writing or implied. An individual who contracts to do work for a customer or client of their business undertaking or profession is specifically excluded (for example, an employer company contracts with a trader business to provide certain services or contracts with a professional firm, such as external lawyers, to provide legal advice).

This therefore covers full-time, part-time, fixed-term/temporary and agency workers, where there's a contract with the employer to do work for them (not as part of a business relationship).

There are special provisions in the Pensions Act 2008 for agency workers who don't have a worker's contract with either the principal or agency, as employer, and also for company directors, the armed forces, those in Crown employment or working offshore or on vessels, and certain others.

A company director isn't a worker unless they're employed by the company under a contract of employment, and at least one other person is employed. In other words, one-person companies aren't included in the legislation.

## What is a qualifying scheme?

In relation to the UK, a qualifying scheme is:

- an occupational pension scheme (as defined in section 1(1) of the Pension Schemes Act 1993), or
- a personal pension scheme registered under the Finance Act 2004

Which, while the employee is an active member, meets the quality requirements in relation to the staff.

There are different quality requirements for different types of schemes. These are:

**Defined benefit (DB) schemes.** There are two ways in which DB schemes can qualify:

- All schemes that are contracted out of the State Second Pension (S2P) will meet the quality requirement.
- Schemes whose members aren't contracted out of S2P must meet the test scheme standard. Broadly, this means these schemes must have a benefit accrual rate of 1/120th of average qualifying earnings for each year of membership.

**Defined contribution (DC) schemes, including GPPs.** To be a qualifying scheme, the total contributions should be a minimum of 8% of an employee's qualifying earnings, of which the employer contribution must be at least 3%.

**Hybrid schemes.** These must satisfy the DB and DC tests in proportion to the benefits that are defined benefit and defined contribution.

### **I'm registered abroad – what does that mean for me?**

Cross-border schemes are complex and you should take advice about how the law applies to you.

### **Will charges be the same for private pension schemes and the National Employment Savings Trust (NEST)?**

A Private Pension scheme can be arranged with similar overall charges to the employee but with the added benefits of:

- Advice to members at the outset
- Ongoing support and advice to members and employer
- More flexibility and choice regarding contribution levels and investment choice

It is anticipated that the NEST annual management charge will be 0.3% over the longer term however an additional charge of 2% on contributions will be charged initially to meet the costs of establishing the scheme. There will be no advice provided to members and the options will be restricted due to this.

### **How will contributions be collected?**

The new process is different from that which most employers currently use. You'll have to deduct contributions from staff from the first pay date after their auto-enrolment date.

### **How will the Pensions Regulator know if I have a qualifying scheme in place?**

You'll have to 'register' (probably online) to tell the Pensions Regulator which pension scheme you're using to comply with their duties.

### **What happens if I fail to carry out my responsibilities?**

All employers – regardless of the number of people they employ, except for single-person companies – will have to comply with pensions reform legislation. The Pensions Regulator will monitor employers to make sure they comply with the legislation. Measures can be taken against employers or third parties where there has been a breach. These include the issue of a

compliance notice or unpaid contributions notice, which, if not complied with, may be followed by the issue of a fixed or escalating penalty notice.

### **How will employers be told about their new responsibilities?**

The Pensions Regulator will make sure that you're aware of your duties and how to comply with them. The Pensions Regulator is planning a programme of targeted communications campaigns.

### **Will the new legislation be reviewed after 2012?**

Yes. The Department for Work and Pensions (DWP) made a commitment to monitor the effectiveness of the new legislation from 2012, and will review the policies in 2017.

## **What does this mean for working individuals?**

### **How will it affect working individuals?**

Working individuals, if they're eligible, will be automatically enrolled into a qualifying scheme, be it their employer's pension scheme or the National Employment Savings Trust (NEST).

The working individual doesn't need to do anything to become an active member of the scheme – their employer must make all the arrangements. If the individual doesn't opt out, a total of 8% of the employee's qualifying earnings must be contributed, with at least 3% coming from the employer.

### **How will employees know about the new requirements?**

It will be the responsibility of the Department for Work and Pensions (DWP) to keep employees informed about how the pensions reform will affect them.

Also, the legislation will require you to give your employees information about how automatic enrolment will affect them.

### **What is opting out?**

An employee who is enrolled (whether this is through automatic enrolment, automatic re-enrolment or exercising the right to opt in) has the right to opt out within the opt-out period. In this event, the employee is treated as if the enrolment that had just taken place hadn't happened.

### **How will an employee tell us they want to opt out?**

The employee has one month (six weeks if the form is invalid) after they've been automatically enrolled during which they may choose to opt out of their employer's scheme.

But before they can opt out, they must be given certain information about the scheme they've been enrolled into. This is to make sure they fully understand the effect and benefits of automatic enrolment before deciding to leave the scheme. If the employee chooses to opt out

within the opt-out period, the employer will refund them any contributions made. The process for opting out is set out in the regulations.

### **How are the self-employed individuals affected?**

The government has indicated that the self-employed can opt into the National Employment Savings Trust (NEST) if they wish but, by definition, they'll receive no employer contribution.

## **The regulators**

### **What is the Department for Work and Pensions' role?**

The Department for Work and Pensions (DWP) is the government department responsible for the development of UK pension policy and the law governing UK pension schemes.

The DWP sponsors a wide range of public bodies to achieve its objectives, including the Pensions Regulator and Personal Accounts Delivery Authority.

### **What is the Financial Services Authority's role?**

The Financial Services Authority (FSA) is an independent non-governmental organisation responsible for regulating financial services. This includes the regulation of the sale and marketing of personal and stakeholder pensions to individuals.

The FSA also oversees the financial viability of organisations that manage pension investments, and can take action to make sure that the individuals who run financial organisations are fit and proper for the task.

### **What is the Pensions Regulator's role?**

The Pensions Regulator is the UK regulator of work-based pensions. The Pensions Act 2004 gives it three main statutory objectives:

- to protect the benefits of members of work-based pension schemes
- to promote good administration of work-based pension schemes, and
- to reduce the risk of situations arising that may lead to claims for compensation from the Pension Protection Fund

The Pensions Act 2008 gives the Pensions Regulator a new objective to maximise compliance with the new employer duties, as well as the safeguards to protect employees who want to save in a pension.

### **What is the Personal Accounts Delivery Authority's role?**

The Personal Accounts Delivery Authority (PADA) has been established by the Pensions Act 2007 to deliver the National Employment Savings Trust (NEST). It's a non-departmental time-limited public body. Once the scheme has been delivered, PADA will hand over to the NEST Corporation.

## More about the National Employment Savings Trust (NEST)

### What is the National Employment Savings Trust (NEST)?

This is aimed at low to medium earners who don't have access to a pension scheme through their employer, and is intended to complement existing workplace pension provision. It will be a qualifying scheme under the government's reforms and will be set up as a large trust-based occupational pension scheme, with employers' and members' panels to represent their interests. It will be run by the National Employment Savings Trust Trustee Corporation, run by people appointed by the government.

### What options will be available under NEST?

NEST will be a simple scheme with limited choices. It will include a default investment fund plus a few additional investment options.

### Are there any contribution limits under NEST?

Yes, there will be a maximum amount which can be paid into NEST by, or on behalf of, a member. This is likely to be around £5,000 a year. It's possible to pay higher contributions to private pension schemes.