MACFARLANES

THE 2012 PENSIONS REVOLUTION

AUTO-ENROLMENT: CHOOSING THE AUTO-ENROLMENT SCHEME

A key part of preparing to automatically enrol jobholders from the staging date is to choose at least one pension arrangement and decide what the contribution or benefit basis will be. This may also require a review of any existing scheme.

THE MINIMUM REQUIREMENTS

An auto-enrolment scheme must provide:

- **total** contributions of at least **8 per cent of band earnings**; and
- include **employer** contributions of at least **3 per cent of band earnings**;

to a **defined contribution** arrangement that is either a registered **occupational pension scheme** or a **personal pension scheme**. If the employer pays the minimum, the employee must pay 5 per cent of band earnings.

Band earnings are annualised gross earnings between £5,564pa and £42,475pa (previously £5,035pa and £33,540pa), based on the relevant pay period (see the 2012 Pensions Revolution briefing No.1).

There must be a **default investment option** as no action can be required of the employee for auto-enrolment.

TRANSITION PERIOD

Lower minimum contribution levels apply before 1 October 2018. Up until 30 September 2017, minimum total contributions are 2 per cent of which 1 per cent must be paid by the employer and from 1 October 2017 the rates are 5 per cent and 2 per cent.

Transitional contribution bases also apply under the alternatives below. There is a limited option for deferring auto-enrolment for employees already eligible to join a defined benefit or hybrid scheme.

ALTERNATIVES

The 5 per cent employee and 3 per cent employer design is only a minimum. The employer may pay more than 3 per cent of band earnings and may pay the full 8 per cent of band earnings so that no employee contributions are required. There is no maximum level of employee or employer contributions for an auto-enrolment scheme, so higher levels may be fixed for both.

For employers who want to continue using an existing scheme or do not want to use band earnings, further alternative minimum standards can be used under a self-certification process:

For defined contribution arrangements

Option 1: contributions of at least **9 per cent of basic pay** of which the employer pays at least **4 per cent**.

Option 2: contributions of at least **8 per cent of basic pay** of which the employer pays at least **3 per cent** provided basic pay is at least **85 per cent of earnings.** NB the 85 per cent test must be met for each jobholder.

Option 3: contributions of at least **7 per cent of total earnings** of which the employer pays at least **3 per cent**.

For defined benefit schemes

A defined benefit scheme can be used for auto-enrolment but must satisfy a **test scheme standard**. This does not require replication of the test scheme benefits but provision of benefits that are broadly equivalent to it or better. It is possible to self-certify without actuarial advice in some cases.

The test scheme provides:

- a pension from **age 65** increasing to 68 in line with state pension age;
- of **1/120th** of **average qualifying earnings in the last three years** of pensionable service;
- for each year of pensionable service up to 40 years;
- with revaluation and increases in payment on the statutory basis.

Additional requirements apply for career average and hybrid schemes.

CHOOSING A SCHEME

The first decision is often about whether to use **the existing scheme**.

Most auto-enrolment duties do not apply in relation to employees who at the staging date are already in a qualifying scheme. If an existing scheme meets the minimum requirements or any of the alternatives, no action is required for these employees.

The decision for the employer will then be about whether to extend the existing scheme and use it for auto-enrolment for all jobholders or, indeed, whether to close it or change the benefit design. Cost, two-tier workforce issues and administrative ease when automatically enrolling employees on day 1 who may opt-out will all be relevant.

Subject to discrimination law, it is permissible to use more than one scheme or arrangement for different groups of employees. For instance, an existing scheme could be used only for employees who joined before a certain date, employees with a certain length of service or minimum age, with all other employees being automatically enrolled into a new arrangement based on minimum requirements.

If there is no existing scheme or a new auto-enrolment scheme is required for all or some employees, the options are between:

- an occupational pension scheme set up under trust by the employer group or as part of an existing scheme (this is the only option for a defined benefit design);
- a group personal pension plan or other contract based scheme administered by an external provider; or
- participation in the statutory scheme, NEST.

The decision about GPPP providers and NEST is largely about service standards, charges and options, including investment, maximum contribution and transfer options. NEST is also a trust scheme.

The decision between a trust scheme (such as an occupational pension scheme) and a GPPP is largely about governance and administration. Different documentation is required for each and slightly different procedures apply under the auto-enrolment legislation.

Also, under a GPPP, contributions paid by either the employer or employee cannot be refunded if the employee opts-out unless he was an eligible jobholder on being automatically enrolled and opted out within one month. Under a trust scheme, refunds are available for up to three months and apply even for employees who are enrolled contractually or are not eligible jobholders. However, as auto-enrolment may lead to many "small pots", an employer may find it administratively onerous to use its own trust scheme.

OPTIONS

There is no rule against providing better or different options under an auto-enrolment scheme. Provided there is a default basis so that no action from the employee can be needed, it is permissible to give the employee other options to choose from on investment and contributions (provided the minimum requirements are met).

SALARY SACRIFICE

Under salary sacrifice, the employee agrees in advance to a lower salary in exchange for higher employer pension contributions and often a waiver of all employee contribution requirements. Under auto-enrolment, existing salary sacrifice arrangements can continue. It can be used for jobholders being automatically enrolled, but only with the employee's agreement in advance. In the absence of agreement, auto-enrolment is required to proceed normally. HMRC has recently amended its salary sacrifice guidance to allow more flexibility in connection with auto-enrolment.

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