Hall Morrice
Chartered Accountants

KEY GUIDE

Introducing auto-enrolment and NEST

Introduction

Auto-enrolment is the Government's chosen way to encourage private pension provision, which no employer – however small – or employee can afford to ignore.

'One of the biggest reforms in decades'

On 1 October 2012 the first phase of a radical set of pension reforms got underway. Whether you are an employer or an employee – or both – you cannot afford to ignore these major changes. For once, they are not concentrated on the arcane world of pension taxation. Instead their focus is firmly on what pensions are all about: the provision of retirement income. The National Association of Pension Funds described a key aspect of the revisions as 'one of the biggest reforms to UK pensions in decades.' The Department for Work and Pensions (DWP) says that the new pension rules 'could almost double private pension income by the time people now starting work reach their retirement.'

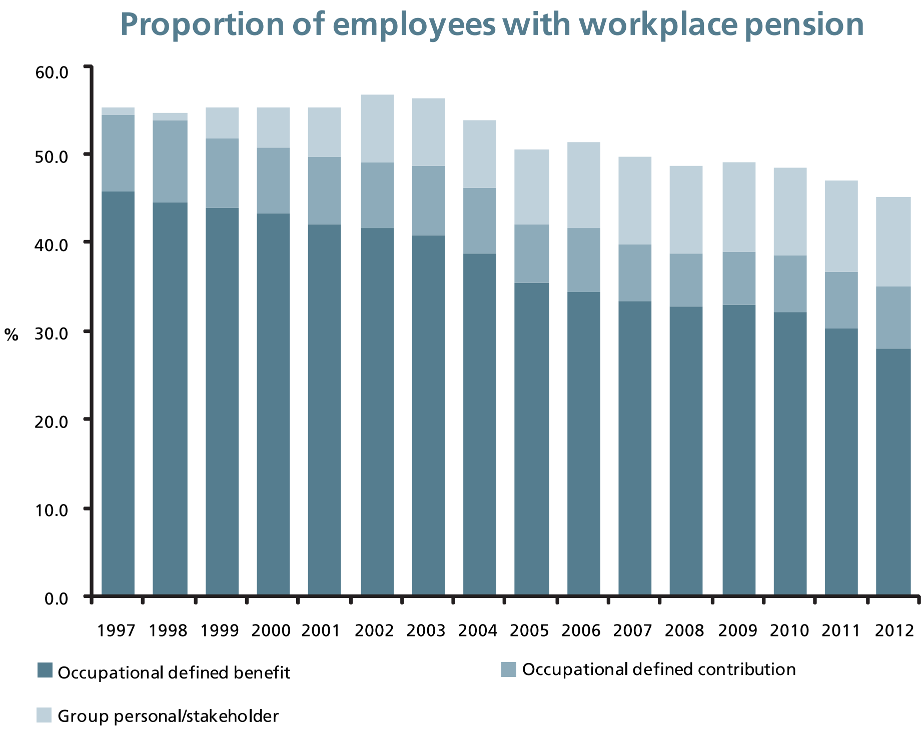
Nudge, nudge…

The reforms all hinge on the introduction of one new principle: the automatic enrolment of employees and certain other workers into workplace pension schemes. The idea is not new: it was originally floated in the first report of the Pensions Commission, back in 2004. That in turn drew on 'nudge theory' – the notion that individuals can be 'nudged' into taking beneficial actions that they might otherwise avoid, such as joining and contributing to a pension plan.

Focus point

For various reasons the numbers contributing to private pensions have been declining for years.

An increase in private pension provision has been an aim of successive governments, primarily motivated by a desire to reduce old-age dependency upon the state. However, for various reasons the proportion of people who are members of workplace pension arrangements has been declining for years, as the graph shows.



Auto-enrolment – the basics

The easiest way to understand auto-enrolment is to work through a few simple questions.

Who?

If you are an employer, you have to automatically enrol your eligible ‘jobholders’ (which has a broader definition than ‘employee’) who:

- Are not already in a suitable workplace pension scheme.
- Are aged 22 or over.
- Are under state pension age (a moving target, these days).
- Earn more than ££9,440 a year in 2013/14 (a figure which currently matches the income tax personal allowance, and which is therefore likely to rise to £10,000 in 2014/15).
- Work, or usually work, in the UK.

Some complex legislation determines whether an existing workplace pension is good enough to mean auto-enrolment is not required. Many existing pension arrangements will fail to qualify, not least because they cover only basic pay rather than total pay.

Focus point

By 1 October 2013, all employers with a PAYE scheme membership of at least 800 will be required to operate auto-enrolment.

When?

Auto-enrolment is being phased in with various ‘staging dates’ running to 1 February 2018. The first staging date, 1 October 2012, applied to the largest employers (those with a PAYE scheme size of 120,000 or more on 1 April 2012). By 1 January 2014, all employers with a PAYE scheme membership of at least 500 will be required to operate auto-enrolment.

Small employers (defined as those with a PAYE scheme membership of fewer than 50 employees) will not now be required to start auto-enrolment until at least June 2015. There is no exemption for employers with fewer than five employees, a floor that applied under the now defunct stakeholder pension employer access rules.

In theory there is nothing to prevent an employer beginning auto-enrolment earlier than its official staging date, although in practice it is hard to see why it would, given that it would bring forward the need to make contributions.

If you are a ‘jobholder’, you can opt out of auto-enrolment at any time because the regime is not compulsory. If you do opt out, however, you will be automatically re-enrolled at a later date, usually after three years or when you change employers. On the other hand, if you are an employee who does not qualify for auto-enrolment (for example, because you are past the state pension age), you can opt in or join your employer’s auto-enrolment scheme once it is established. Your employer, however, will only be required to make contributions to the scheme if your earnings are above the lower earnings limit (£5,668 in 2013/14 terms).

How much?

Auto-enrolment requires a minimum overall level of pension contribution to be made for eligible jobholders as a percentage of their 'qualifying earnings'. These are defined to include overtime, commission and bonuses and several statutory payments. In 2013/14 this covers a band between £5,668 (the national insurance contribution (NIC) lower earnings limit) and £41,450 (the NIC upper earnings limit). The thresholds will be reviewed each tax year, but will not necessarily continue to match the revised NIC limits.

There is a minimum employer contribution and a minimum overall contribution, both of which are being phased in.

Period	Minimum employer contribution % of qualifying earnings	Minimum total contribution % of qualifying earnings
1/10/2012 – 30/9/2017	1	2
1/10/2017 – 30/9/2018	2	5
1/10/2018 onwards	3	8

The minimum total contribution includes basic rate tax relief (currently at 20%) on any employee contribution, so where the employer pays the minimum required from October 2018, if tax relief is unchanged the overall contribution will be split as:

Contribution based on 'qualifying earnings'	%	Based on £25,000 earnings and 2013/14 limits
Employer minimum	3	£579.96
Employee net	4	£773.28
Tax relief on employee contribution	1	£193.32
Total	***8***	***£1,546.56***

Focus point

There are potential financial penalties of up to £10,000 a day for employers who fail to implement auto-enrolment, and additional penalties for those who encourage employees to opt out.

Alternatively, the employer can certify that contributions meet one of three alternative contribution bases, which are more likely to allow the scheme to continue unchanged. Under these, almost all staff will receive contributions at least as high as under the standard basis.

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Where?

The auto-enrolment contributions must be invested into a suitable workplace pension arrangement. There is a range of possibilities for employers to consider.

- A new in-house scheme, designed to meet the legislative requirements.
- An existing in-house scheme, although this may need amendments to satisfy the regulations.

- A group personal pension.
- A 'master trust' scheme, covering the employees of a number of employers.
- The National Employment Savings Trust (NEST).

A mix-and-match approach is possible, perhaps with more senior employees allocated to an in-house scheme and a group personal pension for the mainstream workforce.

National Employment Savings Trust

One of the issues identified early on in the planning for auto-enrolment was the need for a simple, low-cost pension arrangement to help employers with little or no experience of pensions to meet their new obligations. The legislation that created the auto-enrolment rules was therefore accompanied by provisions to establish such a scheme, now called NEST (National Employment Savings Trust).

NEST is run by a non-departmental public body and the scheme's set-up costs were funded by a loan from the DWP that is to be repaid from future NEST charges. NEST is not a government pension scheme, although the DWP does have the power to appoint the chairman and approve appointments of both executive and non-executive employees.

- It is an occupational pension scheme that any employer can use to meet their auto-enrolment requirements.
- The benefits are the same as other occupational schemes, so at retirement up to 25% of the member's fund can be drawn as a lump sum, free of tax. The remainder must provide an income, usually through an annuity.
- The scheme has low charges – 1.8% of each contribution and an annual management charge of 0.3% of each member's fund.
- By default, contributions will be allocated to a target date fund based on the year when the member reaches state pension age. However, there is the option to invest in any of five other funds or select a different target date.
- There is an overall contribution limit of £4,600 in 2013/14, and no transfers into NEST will be allowed before at least 2017.

A game of consequences

The creation of NEST is not the only consequence of the decision to introduce auto-enrolment. The Government is now legislating for the introduction of a single-tier state pension of about £144 a week to replace both the basic state pension and the additional state pension (S2P). This state pension of about £144 a week. The aim behind this major upheaval is to limit the risk that some lower earning individuals would be better off opting out of auto-enrolment and relying solely on state retirement benefits.

Auto-enrolment has also prompted the Government to start thinking about how to handle the many small pension pots that will be created as a result of increased pension scheme membership in sectors of high job-mobility. Various proposals, including automatic transfer to the new employer's pension scheme, are currently at the consultation stage.

Focus point

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What now?

If you are an employer

Auto-enrolment imposes new duties and, potentially, additional costs on your business. The first point of call is to find out your firm's staging date – in other words, when you must auto-enrol your existing workforce. While that date may be several years off, the earlier you start planning the better because there are many points to consider, all of which could require expert advice.

Focus point

For employers, auto-enrolment imposes new duties and, potentially, additional costs. For employees, auto-enrolment should prompt a review of existing retirement planning.

- If you have any existing pension arrangements, could or should they be amended to meet the auto-enrolment provisions?
- If you have no existing workplace pension, what route should you take?
- What impact will compulsory employer contributions have on your business's finances?
- How will your current payroll system identify those eligible for auto-enrolment and cope with the collection, payment and refunds of contributions to those who opt out?
- When should you start communicating to your workforce?

If you are an employee

The prospect of auto-enrolment should prompt you to review your existing retirement planning. The questions you need to discuss with your financial adviser include:

- Should I opt out? Usually this would not make financial sense because you would lose your employer's contributions. In a few instances, however, opting out will preserve major tax benefits which would otherwise be lost.
- What should I do with my existing pension arrangements?
- If I am auto-enrolled, should I make additional contributions to my pension?
- What investment strategy should I adopt for my auto-enrolment pension contributions?

There are obviously many questions to consider, and few straightforward answers. We are specialists and here to help you.

Hall Morrice
Chartered Accountants

6&7 Queens Terrace Aberdeen AB10 1XL
Tel 01224 647394 Fax 01224 639541
E-mail accounts@hall-morrice.co.uk Web www.hall-morrice.co.uk