

## Auto-enrolment: three years and counting

Updated February 2016

Pension briefing

### HIGHLIGHTS

Large employers were required to begin automatically enrolling workers into qualifying pension schemes from October 2012, and all employers employing more than 50 employees became subject to the new regime by April 2015. Under the auto-enrolment regime:

- All employers, regardless of size, are obliged to enrol "jobholders" who earn more than £10,000 and are aged 22 to state pension age, automatically in a pension scheme meeting the "quality requirements", unless the jobholder falls within one of a limited number of exceptions.
- Employers can use an existing scheme or a new arrangement for auto-enrolment, as long as it meets certain requirements. These requirements vary depending on the type of pension arrangement.
- Employers also need to enrol those who do not qualify for auto-enrolment into a pension scheme if they so request. They need to pay contributions for those earning more than "qualifying earnings".
- Employers must conduct a re-enrolment exercise every three years.
- Until 2018, only minimal contributions will be required.
- From April 2019, employers using a DC scheme for auto-enrolment must ensure that contributions equalling 8% of qualifying earnings are paid into the scheme for each qualifying jobholder (with 3% coming from the employer). Alternatively, an employer may certify that minimum levels of contributions are being paid.

An eligible jobholder must be auto-enrolled within three months of the date on which he or she first meets the age and income requirements. Notice requirements apply immediately, however.



### Key phrases

- "earnings trigger" is the annual income that a jobholder must be earning in order to be eligible for automatic enrolment. It is currently set at £10,000.
- "entitled workers" are workers aged 16-74 who work or ordinarily work in Great Britain under their contract but who do not have qualifying earnings in a pay reference period. Entitled workers must be enrolled on request.
- "jobholder" is a worker aged 16-74 who is working or ordinarily works in Great Britain under their contract and who earns qualifying earnings in a pay reference period. Jobholders between the ages of 22 and state pension age are "eligible jobholders" who must be auto-enrolled if their earnings are equal to, or exceed, the earnings trigger. Jobholders who are 16-21, or between state pension age and 74, and who earn at least the earnings trigger, are "non-eligible jobholders".
- "pay reference period"
  - for the purpose of determining whether a jobholder has qualifying earnings, is based on the worker's normal pay cycle (eg weekly, bimonthly or monthly pay periods). As an alternative, an employer can use a pay reference period aligned to tax weeks or months; and
  - for the purposes of determining whether there has been sufficient pension accrual in relation to qualifying earnings (in order to assess whether a scheme meets the quality requirements), is one

year. Alternatively, one of the two definitions for qualifying earnings referred to in the paragraph above can be used.

- "qualifying earnings" are earnings, including salary, wages, commission, bonuses and overtime, equivalent to £5,824-£42,385 annually for 2015/16, pro-rated over a pay reference period. "Qualifying earnings" are likely to differ from "pensionable pay" under most schemes.
- "worker" is an individual, including an individual who is self-employed under the tax laws, who "undertakes to do work or perform services personally" except as a "profession or business undertaking". The definition is very broad; contractors and some casual workers may fall within it depending on the particular facts.

### AUTO-ENROLMENT - THE BASICS

#### Who is affected?

Every employer, no matter what size, and any individuals who work (or ordinarily work) for them in Great Britain either as employees or under a contract of services will be affected by the requirements.

Employers must automatically enrol eligible "jobholders" (see box) who are aged 22 to state pension age and have earnings of at least the level of the "earnings trigger" (currently £10,000 on an annual basis) into a scheme meeting certain minimum quality requirements (see below). Other workers must be given an opportunity to opt in.

Each employer was given a "staging date" based on PAYE size on 1 April 2012. The largest employers began auto-enrolment in October 2012; employers could bring forward their staging date (to align with other key dates in their calendars, for example).

The obligations are being phased in gradually. So, where the employer auto-enrols jobholders into a defined contribution scheme:

- the minimum contribution during the initial phasing period (2012 - 2018) is 2% of qualifying earnings, with a 1% minimum employer contribution; and
- in 2018 the rate will rise to 5% in total, with a 2% minimum employer contribution.

By 6 April 2019, all employers should be auto-enrolling eligible jobholders into a fully qualifying scheme with 8% contributions, 3% coming from the employer.

There is also an optional transitional period ending on 30 September 2017 for existing employees who are eligible to participate in qualifying defined benefit and hybrid schemes with defined benefits (but have not opted to join).

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

Automatic enrolment, or auto-enrolment, is the process under which an employer arranges for an eligible jobholder to be automatically enrolled in a pension scheme that meets the minimum requirements.

Every three years, employers have to automatically re-enrol eligible jobholders who opted out of the original auto-enrolment, unless they are already active members of a qualifying scheme. When implementing re-enrolment employers can take advantage of the exceptions that were introduced in 2015 (see below). Once re-enrolled, the worker has the right (as before) to opt out within the statutory one month window.

Employers must choose a re-enrolment date – any day three months either side of their staging date's third anniversary. Unlike the original staging date (when employers could set different auto-enrolment dates for different groups of workers), the re-enrolment date cannot be postponed for individual workers. Once re-enrolment is completed, employers must re-register with the Pensions Regulator (tPR) in the form of a fresh declaration of compliance. If there are eligible workers to re-enrol, this must be done within two months of the re-enrolment date. Otherwise, the deadline is the third anniversary of the first declaration.

#### How does auto-enrolment work?

Basically:

- The employer must auto-enrol each eligible jobholder retrospectively to the "auto-enrolment date" (AED) within six weeks of that date.
- The AED is normally the staging date or the beginning of the first pay period after which the jobholder becomes eligible, but could be deferred by the employer for up to three months, for example if the employer wants to align it with payroll dates.
- Each eligible jobholder must be given enrolment information within six weeks from the AED, including details of the opt out period. The opt out period is a period of one month beginning on the later of:
  - the date on which the jobholder "achieves membership" in the pension scheme; and

- the date on which the jobholder receives information about the scheme from the employer or the employer's agent.

- In the meantime, the employer must deduct the eligible jobholder's contribution from his first pay packet after the AED (or the deferral date if this option is taken). Contributions deducted during the first three months of membership must reach the scheme by the 19<sup>th</sup> of the fourth month (or the 22<sup>nd</sup> if the payment is sent electronically).
- If the jobholder opts out during the opt out period, he or she must be treated as though he or she had never been a member.
- If the jobholder does not opt out, he or she must remain an active member of a qualifying scheme unless he or she chooses to leave active membership.

#### Do we need to auto-enrol all employees?

All workers who are eligible jobholders (that is, those aged 22 – state pension age who meet the earnings trigger) must be auto-enrolled. The definition of "worker" is very broad (see box above). In particular, self-employed persons providing services as part of a business carried on by someone else can be workers.

From April 2015, employers have discretion not to auto-enrol/re-enrol:

- Workers who are due to leave their job (having received or given notice following resignation, dismissal or retirement) within a period of six weeks from their auto-enrolment/re-enrolment date.
- Jobholders who have, within the last 12 months, cancelled their scheme membership under the rules or opted out during the statutory opt-out period.
- Jobholders who the employer has "reasonable grounds to believe" have claimed protection against the lifetime allowance tax charge (covering primary protection; enhanced protection; fixed protection 2012 or 2014; and individual protection 2014). Although the onus is on employees to let the employer know that they have protection, employers will want to see the HMRC certificate before relying on this exception.
- Workers who have received a winding-up lump sum within the last 12 months and who, since the lump sum was paid, have ceased to be employed then been re-employed by the same employer.

Non-eligible jobholders and entitled workers must be given written information about their rights to opt into or join a pension scheme and:

- A non-eligible jobholder may opt in to a qualifying scheme, and the employer must pay the minimum contribution.
- A jobholder earning less than the earnings trigger but more than the qualifying earnings threshold may opt in to a qualifying scheme and the employer must pay the minimum employer contribution.
- A worker whose earnings are too low to be qualifying earnings may choose to enrol in a registered pension scheme, which must be furnished by the employer, although it does not have to meet the quality requirements. No employer contribution, or minimum employee contribution, is required.

### Contractual enrolment

Some employers enrolled its jobholders (or all workers) into a pension scheme (either the employer's existing scheme or a new arrangement), under their terms of employment – "contractual enrolment".

Provided the scheme meets the quality requirements, the employer did not then have to auto-enrol on the AED, as jobholders were already members of a qualifying scheme on the date the requirements would otherwise have applied.

The employer still needed to register the scheme with tPR and provide certain information about the pension scheme to workers but the requirements are a little less onerous than under auto-enrolment. In particular, the requirement to continually assess a worker's eligibility for auto-enrolment is avoided.

The statutory right to opt out of scheme membership does not apply to a jobholder who is contractually enrolled, so opting out has to be in accordance with scheme rules. If a contractually enrolled worker decided to leave the scheme he or she would then become subject to the auto-enrolment requirements.

If an individual who registered for protection is auto-enrolled, protection is retained provided the individual opts out within the statutory window. But an individual with protection who is contractually enrolled will normally lose protection on becoming a member unless (for occupational schemes) the rules contain a provision saying that a member who opts out was never an active member.

### Compliance

The Pensions Regulator is charged with monitoring compliance and enforcing the provisions. Each employer is required to register with tPR and provide certain information. The intention is that this information may be readily compared against HMRC records, enabling tPR to identify employers who are failing to comply.

The potential penalties are significant and could reach £10,000 a day for larger employers.

### Notice to workers

The auto-enrolment regime includes requirements to notify workers of their rights within tight timeframes. These information requirements vary according to the type of worker but are not limited to jobholders.

The general requirements for trustees to disclose information about their scheme to new members are separate from the auto-enrolment information requirements. However, as part of a move to align the two sets of rules (and to ensure that members receive scheme information before the end of the auto-enrolment opt-out period), trustees must now supply basic scheme information to a new employee who is subject to auto-enrolment within one month (rather than two) of the date the scheme receives statutory information about the jobholder.

### Record-keeping and provision of information

Employers must keep records of each jobholder's AED and, where applicable, his or her opt out notice, along with information concerning earnings and contributions. Trustees and providers must keep records of the dates on which jobholders achieve and leave active membership (including records concerning members who have opted out), as well as personal data such as name, National Insurance number and residential address, even where the member opts out.

### Prohibited recruitment conduct and inducement

Employers are prohibited from engaging in conduct that encourages opting out.

"Prohibited recruitment conduct" consists of statements or questions that indicate that an applicant's job prospects may be conditional on opting out. Similarly, once a jobholder is in employment, an employer may not take an action "for the sole or main purpose" of inducing that member to opt out or end active participation in the pension scheme. There is some uncertainty around what constitutes an "inducement" and the circumstances in which the terms of a flexible benefits plan could be considered inducement.

Employers must not offer financial inducements to opt out. For example, offering a higher salary or bonus in return for opting out of the scheme.

### What happens if there is a business transfer?

Where workers change employer as a result of a business transfer or outsourcing under the Transfer of Undertakings (Protection of Employment) Regulations (TUPE), the new employer will be responsible for complying with the employer duties for those workers. They are treated as new joiners for the employer and must be automatically enrolled if appropriate.

Employers should note that the auto-enrolment obligations are in addition to (and operate separately from) requirements under TUPE for transferee employers to provide certain minimum levels of benefits to transferring employees. However, from April 2014, a transferee who offers transferred employees a money purchase scheme will be able to satisfy its TUPE obligations by paying contributions that match those paid by the transferor immediately before the transfer, instead of matching employees' contributions.

### What has happened to stakeholder pensions?

Before auto-enrolment, there was no requirement for an employer to contribute to a pension scheme for employees but an employer with five or more employees was obliged to designate a stakeholder pension for their employees. This requirement was abolished from October 2012 for all employers regardless of staging dates. Employees who were already members of stakeholder schemes are entitled to continue to have contributions deducted from salary and paid to the stakeholder scheme.

### THE NEST SCHEME

To aid employers who might otherwise have difficulty establishing or finding an appropriate qualifying scheme into which to auto-enrol workers, the Government established the National Employment Savings Trust (NEST).

NEST is a DC arrangement targeted at lower-income members, and is intended to be low-cost. There are currently restrictions: a contribution limit, set at £4,600 per annum for 2014/15; and a prohibition on transfers to other pension schemes (except after age 55, on incapacity or as a result of a pension sharing order) and on NEST accepting bulk transfers. These restrictions will be removed from April 2017.

Several companies have established themselves as competitors to NEST, offering similar "master trust" products.

## DOES MY SCHEME MEET THE QUALITY REQUIREMENTS?

Both occupational and personal pension schemes may be used for auto-enrolment provided there is nothing in the rules of the scheme which would act as a barrier to auto-enrolment – such as an age restriction of 21 or requirements to provide information or give consent in order to become a member. The requirements differ depending on the type of scheme being offered. Those for defined contribution (DC) and final salary defined benefit (DB) schemes are summarised below; there are some variations for career average, cash balance and hybrid schemes.

### DC scheme

From April 2019 the default statutory requirements for DC schemes will be a minimum contribution of 8% of qualifying earnings with at least 3% contributed by the employer.

However, where an employer's contributions are calculated by reference to pensionable pay (as opposed to qualifying earnings), as in most existing schemes, an employer may self-certify its scheme (for some or all jobholders) if it can show that total contributions over a one year period are at least:

- 9% of pensionable pay, with an employer contribution of 4%; or
- 8% of pensionable pay, with a 3% employer contribution, where pensionable pay constitutes at least 85% of the total pay bill; or
- 7% of pensionable pay, with a 3% employer contribution, where 100% of the total pay bill is pensionable.

"Pensionable pay" in each case must be at least equal to basic pay. Basic pay is earnings disregarding payments such as commission, bonuses, overtime and allowances.

A DC scheme must have a default investment into which a member may be enrolled without making any choice.

### Traditional final salary defined benefit scheme

If the scheme is contracted-out of the state second pension on the reference scheme basis it will automatically meet the minimum requirements.

A non contracted-out scheme must show that it provides benefits broadly equivalent to the "test scheme" requirements.

The "test scheme" requirements are that 90% of relevant members must be provided with benefits of equal value to a DB scheme:

- in which the accrual rate for each year of pensionable service is 1/120th of average qualifying earnings in the last three years of pensionable service;
- with a normal retirement date of 65 (gradually rising to age 68 in line with increases to the state pension age);
- that "inflation proofs" deferred pensions and pensions in payment in accordance with current requirements for DB schemes.

### Alternative funding accruals test for defined benefit schemes

Ahead of the abolition of contracting-out from April 2016, a new way for a previously contracted-out DB scheme to satisfy the quality requirements has been added – assessing the cost of benefit accrual.

The test is based on the cost (certified by the actuary) of future accrual under the scheme for active members accruing all benefits, including survivors' benefits, over a look-back period of 12 months (or the gap between actuarial reports). Depending on the definition of earnings used, accrual valued equal to or better than 9% to 13% of relevant earnings is permissible.

In calculating the cost of accrual, actuaries will use methods and assumptions already used for other purposes, such as scheme funding. Where there is a material difference in the cost of providing benefits to different groups of members, the actuary can do separate calculations. An employer in a multi-employer scheme can choose to apply the quality test for its employees separately.

Interaction with the new annual allowance may cause some tricky actuarial issues – capping accrual for high earners might result in the tests for DB schemes not being met.

### WHERE CAN I GET MORE INFORMATION?

The Pensions Regulator has published a series of useful guidance regarding employer duties and automatic enrolment that is available at

<http://www.thepensionsregulator.gov.uk/pensions-reform.aspx>

The Government has published guidance for employers on certification of schemes at:

<https://www.gov.uk/government/collections/automatic-enrolment-guidance-for-employers-and-actuaries>

This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

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