Pensions Talk, September 2012

Auto-enrolment Update

Workplace pension reform law came into effect from 1 July 2012. Although for many employers it may be several years before they will need to start fully complying with the legislation, new laws have now come into effect to safeguard rights of employees and prevent employers from encouraging or forcing employees to opt-out.

The new law places requirements on employers to ensure they do not:

- Induce workers to opt out or to cease membership of the pension arrangement.
- Indicate during the recruitment process that a worker's decision to opt out of the pension arrangement will affect the outcome.
- Do, or fail to do, something which results in the worker ceasing to be in active membership whilst still employed by their employer.

The Pensions Regulator has issued its approach with regards to non-compliance on auto-enrolment duties. It recognises that there may be employers who have failed to meet their duties because they have not understood what is required of them. These circumstances will be dealt with on a case by case basis and where necessary the Regulator will work with employers to help them achieve compliance.

However, it is also recognised that there will be a small number of employers who may choose to ignore their responsibilities. The following will apply to such employers:

- Employers who fail to comply with their duties may be subject to statutory notices, penalties or escalating fines.
- The Regulator will have the power to issue a fixed penalty of £400 to an employer as well as an escalating penalty at a daily rate. Escalating penalties are set at a level to fine an employer the cash flow benefit they gain from non-compliance. These range from £50 for the smallest employers (between one and four employees) to £10,000 for those with more than 500 employees.

- To help detect behaviour outlined above, the Regulator will provide a whistle blowing facility through which confidential reports can be made.

For further information regarding auto-enrolment, please click here.

Principles of Good Workplace Pensions

In the last edition of Pensions Talk we referred to the six principles of good workplace pension schemes. The Pension Regulator has now published further guidance which details a draft key features that effectively expand upon these six principles. This provides a framework for employers and pension providers to allow them to demonstrate that the pension arrangements they offer are fit for purpose. These principles apply to defined contribution pension arrangements only.

With the demise of defined benefit arrangements, increasingly employers are offering defined contribution arrangements (such as Group Personal Pensions) to their staff. With the introduction of auto-enrolment later this year, the number of such arrangements is likely to increase further. Although many of these will be good quality arrangements, they do not have the compliance requirements associated with defined benefit arrangements. The idea behind these new principles is to help employers and pension providers identify, amongst other things, the value for money and services offered to employees and to help raise standards amongst this type of pension arrangement.

There are 36 proposed principles or key features under the new proposals. These fall into the following categories:

- Essential characteristics – these cover things such as costs, fair treatment of members, contribution structures and investment options.
- Establishing governance – these deal with governance under the arrangement and those involved with the process.
- People – these features address the key persons involved with running the pension arrangement.
- On-going governance and monitoring – these deal with those involved with the on-going governance and monitoring of the scheme to ensure that there are adequate controls in place. This also looks at reviewing the investment options under the arrangement, in particular the default fund.
- Administration – these features look to ensure administration is accurate and timely.
- Communications to members – these look at the way in which matters are communicated to members.

How can One Pension Consultancy help?

We already carry out annual governance reviews on all of our Group Personal Pension plans. As part of this process we have now included details on how these principles are met (where applicable) or what action is required in order to meet them. We can also produce communication on how your arrangement meets these principles for issue to employees if this is required. It should be noted that we include this as part of our standard services on this type of arrangement and we do not seek to make an additional charge for doing so.

Department of Work and Pensions to implement "pot follows member" system

The Department of Work and Pensions have announced that they will implement a system of "pot follows member" for those auto-enrolled under the new legislation. This is to prevent large numbers of dormant pension pots accumulating as employees are auto-enrolled from one employment to another.

In order to look at this issue, three possible solutions were considered; creating an "amalgamation house" for small pots, making it easier to merge small pots and allowing pensions to be transferred by default. Following on from this, the Department of Work and Pensions have opted for the "pot follows member" solution. This means that if on leaving employment the employee has accumulated a "small pot" under their previous employer's arrangement, this will automatically be moved to the pension arrangement of their new employer. This will avoid the situation where an employee has several small pension pots accrued throughout their working lifetime and hopefully make this more manageable for the employee.

Obviously key to this system is what is defined as "small". In this respect, the Government will consult on four different levels of pension pots; £2,000, £5,000, £10,000 and £20,000.

It is also key to note that these proposals will initially only apply to new pension pots created where an employee has been auto-enrolled under the new legislation.

Amendments to Salary Sacrifice

HM Revenue and Customs have recently amended the rules relating to salary sacrifice (also known as salary exchange). This increases the flexibility with regards to this type of arrangement and also confirms how this will interact with auto-enrolment once this legislation comes into force.

Salary sacrifice (or salary exchange) is an arrangement whereby an employee agrees to give up part of their salary in return for an equivalent pension contribution from the employer. This is as an alternative to an employee contributing into the pension arrangement from their net pay. So for example, instead of an employer paying a 5% pension contribution and an employee paying a 5% contribution, the employer will pay a 10% contribution and the employee's gross salary is reduced by 5%. From an Income Tax point of view, this has neutral impact however, structuring contributions in this way does mean that the both the employer and the employee save on the National Insurance contributions on the value of the employee contribution.

Previously, it was only possible to amend salary sacrifice once every twelve months or alternatively if the employee had a "lifestyle change". A lifestyle change would be an event such as marriage, divorce or having a baby. These requirements have now effectively been removed and it is no longer necessary to stipulate a period for which the arrangement must be entered into or to set out “lifestyle events”. This gives employees greater flexibility in utilising this facility. For those employers not currently using salary sacrifice, this may make such a scheme more attractive to your employees.

Changes to the State Pension System

In March 2012, two changes to the current state pension system were proposed. One was to replace the current two tier pension system with a flat rate pension, the other to link State Pension Age to life expectancy. However, due to the complexities involved, it has now been announced that full details of these proposals won’t be issued until autumn.

At the moment, the state pension system operates on a two-tier basis. Firstly there is the basic state pension which is payable to all, provided they have paid (or been credited with paying) National Insurance contributions. On top of this there is a top up scheme known as the State Second Pension. This element is payable only for employees and is not available for the self-employed. The proposals are to replace both elements with a flat rate, universal pension of approximately £140 per week.

Whilst in theory a single, flat rate pension sounds preferable to the current system, there are complications which will inevitably arise from switching from one system to another. Firstly, at the moment, the Second State Pension is not available to the self-employed and as such, the self-employed pay lower rates of National Insurance. Also, prior to 2012, many people contracted out of the Second State Pension choosing instead to receive rebates from the Department of Work and Pensions payable to a personal pension. Contracting out in this way began in 1988 and ceased from April 2012. However, it is still possible for members of active, contracted out defined benefit pension arrangements to continue to be contracted out and if this occurs, both the employer and the employee pay reduced National Insurance contributions with the expectation that the savings make up part of the regular contributions to the pension scheme. How these elements will interact with the proposed new system need to be considered in detail and hence the White Paper is now expected to be published in later this year.

Employers may potentially have auto-enrolment duties towards equity partners

Under the new legislation, once an employer reaches its staging date, it will be expected to auto-enrol all eligible employees into a pension arrangement of some kind. However, following a recent judgement in an Employment Appeal Tribunal it may be that equity partners must also be included in this definition.

The auto-enrolment regulations are set out in the Pensions Act 2008 and this act defines, amongst other things the definition of a worker. Although not exactly the same, this definition is very similar to that found under the Employment Rights Act 1996. In the recent case of *Bates van Winkelhof v Clyde & Co LLP* it was found that a fixed equity partner of an LLP fell within the definition of a worker under the Employment Rights Act 1996. This then brings into question whether or not an equity partner should be included as a worker for the purpose of the auto-enrolment legislation.

If an equity partner does indeed need to be classed as a worker under this definition it then needs to be determined which category of worker the partner will fall into under the auto-enrolment legislation. In this respect, the legislation outlines three different types of worker:

- An eligible jobholder – this is someone whom must be auto-enrolled into a pension arrangement and for whom the employer must make a contribution in line with the legislation. An eligible jobholder is someone who is aged between 22 and the State Pension Age (currently 65) and has earnings above the earnings trigger (currently £8,105 per annum).
- A non-eligible jobholder – this type of worker does not need to be auto-enrolled but they do have the right to opt in to the pension and must be notified of this right. If they do opt in then the employer must contribute on their behalf. A non-eligible jobholder is someone who is aged between 16 and 21 or between the State Pension Age and 74 and has earnings above the earnings trigger (currently £8,105 per annum) or someone aged between 16 and 74 who has earnings between £5,564 and £8,105 (current limits).
- An entitled worker – this type of worker must be notified of the pension arrangement and has the right to opt in. However, if they do join the pension the employer does not need to contribute on their behalf. An entitled worker is someone who is aged between 16 and 74 who has earnings below £5,564.

Based on the above, if an equity partner is to be classed as a worker, what action needs to be taken will very much depend upon whether or not "drawings" will be classed as earnings under the legislation. Depending on how this is treated it may be that the requirements for this type of employee are limited to notification. However, employers should be aware that there may be a duty towards equity partners under the auto-enrolment regime.

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