Punter Southall Group

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2012 – It's not about Personal Accounts, it's about auto-enrolment

This is our final note in the DC Survival Guide series, and we look ahead to the future of DC pension provision.

The biggest change on the horizon comes in 2012 (the date is to confirmed) when the Employer Duties commence. At the same time, the personal accounts scheme will be fully launched, as one means of enabling employers to meet their new duties.

What are the employer duties?

In summary, the employer duties are to automatically enrol eligible jobholders into a qualifying workplace pension saving scheme, with a minimum employer contribution.

Automatic enrolment – the employer must make arrangements to ensure that eligible jobholders become active members of a scheme effective from the date they start work (or satisfy the eligibility conditions, if later).

Eligible jobholders – a jobholder is a worker in Great Britain under a contract, aged at least 16 and under 75, with gross earnings between £5,035 and £33,540 (in 2006/07 terms). An eligible jobholder is aged at least 22 but is below State Pension Age.

Qualifying workplace pension saving scheme – can be a Group Personal Pension or Group Stakeholder or Group SIPP, or an occupational pension scheme, meeting the minimum standard for contributions or benefits. Employers can alternatively use the personal accounts scheme to satisfy their duties, as mentioned overleaf.

Minimum employer contribution – it is currently expected (but not confirmed) that this will be phased in over 3 years from 1% of the qualifying earnings described above in the first year, to 2% and then 3%.

Employees will be expected to contribute 4% of qualifying earnings, with around 1% provided additionally by the Government through tax relief.

Can employees opt out?

Yes, although employers must be very careful not to induce employees to opt out. Consultation on the opting-out regulations commenced in March 2009 and ends in June 2009. Based on those draft regulations, it currently appears that the key features of auto-enrolment and opting-out will be as follows:

- Employers must ensure that active membership is achieved within a joining window of no more than 14 days of becoming eligible (usually the date of starting employment or the 22nd birthday if later).
- Membership (i.e. contributions) must be backdated to the date of becoming eligible.
- Specific information must be provided to members during the joining window, and the joining window must be at least 7 days for contract-based schemes to dovetail with their existing requirements around establishing a contract between the provider and the individual.
- After joining has been achieved, a genuine 30 day opt-out window must commence, and the scheme (not the employer) must issue and then store a prescribed opt-out form (which can be electronic).
- If a member opts out during the 30 day window, any contributions deducted are returned from the scheme to the employer, as if the person had never been a member. The employer makes the refund to the employee. By arrangement, employer contributions can be retained by the scheme, for example to meet administration costs.

Clearly some employees will not be prepared to make the necessary level of personal contributions to qualify for the employer contribution, and such employees can be expected to opt out.

More controversially, it has been suggested that some employees should opt out because they cannot secure enough pension benefits (through the minimum contributions) to bring them above the threshold for the existing means-tested Minimum Income Guarantee for pensioners.

To counter such arguments, the DWP commissioned a report published in February 2009 which looked at "payback" – defined as how much employees will receive in retirement for each £1 contributed in pension saving. Clearly, the results depend crucially on the assumptions used for investment returns, inflation and mortality, but the study concluded that 95% of employees will be better off in retirement to some degree as a result of auto-enrolment and the minimum contribution requirements.

What will the impact of auto-enrolment be for employers?

Clearly the intention is to increase the take-up rate for pension scheme membership, with a minimum level of employer contribution. Research shows that employers might expect take-up rates of 70% to 80%.

This could be a significant increase, and could mean that existing schemes are no longer affordable unless steps are taken to reduce contributions or make savings elsewhere to compensate.

Some commentators have suggested that pay increases could be reduced by 1% per annum between now and 2012, to generate the amounts required by way of employer contributions. However, with many employers adopting a pay freeze in 2009, and possibly for some time to come, this may not be viable in practice.

There is evidence that some employers are beginning work to improve take-up rates now, using existing schemes and benefit structures, so that the transition to higher take-up rates is smoothed over a number of years.

Employers will also need to put in place HR and payroll procedures to operate auto-enrolment in practice, for both new joiners and existing non scheme members at implementation or when they subsequently reach age 22.

What are the issues for employers?

Employers who already operate auto-enrolment and/or already have very high take-up rates for a scheme that meets the minimum contribution requirements have relatively little to be concerned about.

However, if as an employer your pension provision has any of the following characteristics, you need to start considering how to tackle the challenges of 2012 and beyond:

- Low take-up rates, especially if the scheme is generous may not be affordable to provide the current level of contributions if take-up rates increase as a result of auto-enrolment.
- Employer contribution rate less than 3% of the new qualifying earnings definition

  An example would be a matched structure, where members can choose to pay only 1% or 2%. This will not meet the minimum standard.
- Pensionable salary defined as basic pay with an offset, with most members earnings under £33,000

  It could be difficult to demonstrate compliance with the minimum employer contribution requirements, which will be policed through a system of "self certification".
- Matching contribution structures with an option to pay up to at least 5%

  Under the employer duties, members will have to pay 5% gross in order to receive an employer contribution of 3%. Under the matching scheme employees who pay 5% will get 5% from the employer. The Employer Duties may, therefore, increase the cost of an existing scheme as there will be encouragement for employees to pay 5%.

What are the issues for schemes, and trustees?

Other than being prepared for changes to benefits and contributions that employers may choose to make, the main change for schemes will be preparations for potentially significant increases in membership and fulfilling their duties in respect of opt-outs within 30 days. Trustees should also expect to manage increased numbers of deferred benefits for ex-employees because of auto-enrolment.

How does the personal accounts scheme fit in?

The personal accounts scheme will be one of the qualifying schemes available for employers to use. However, there is no obligation to use the scheme as the duties can be met using existing arrangements, whether these are trust-based or contract-based, provided these arrangements conform to the minimum standards set by government.

The personal accounts scheme is likely to be most attractive to small and "micro" employers who do not already operate their own schemes, other than perhaps a designated stakeholder scheme which is effectively dormant.

However, other employers may wish to consider using the personal accounts scheme for seasonal workers, employees on short-term contracts and in areas with high first year turnover.

Should employers consider using the personal accounts scheme instead of an existing scheme?

Much of the detail of the personal accounts scheme remains to be worked out over the period between now and a small scale launch ahead of 2012. The Personal Accounts Delivery Authority (PADA) is working hard to create the infrastructure for the scheme.

PADA has already initiated procurement for administration services, and consulted on charging structure and decumulation (the conversion of individual member funds into retirement benefits). It is currently consulting on investment strategy and options.

Employers may wish to compare their existing facilities with the personal accounts scheme once all the details are known, but PADA has made clear that their target market is low to moderate income earners who do not currently participate in a workplace pension. To ensure focus on this market, there will be an annual limit of contributions into a Personal Account of £3,600 (in 2005 terms) and transfers in and out will not normally be permitted.

Where can I get further information?

For further information please speak to Alison Bostock on 020 7839 8600 or email dcsurvival@puntersouthall.com. Alternatively, please speak to your usual Punter Southall Group contact.

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