What is automatic enrolment for pension's purposes?

Overview

Automatic enrolment as a general term usually defines a governmental objective to establish pension schemes in which targeted individuals are automatically enrolled. Using this as a basis for setting up such schemes typically results in far higher participation rates than when individuals are left to opt-in to schemes voluntarily. The introduction of automatic enrolment for workplace pensions is intended to ensure that many more employees begin to make proper provision for having a work based pension.

The new rules for automatic enrolment came into effect on 1 October 2012. With the introduction of automatic enrolment, the requirement for an employer to provide access for staff to a stakeholder pension scheme has been removed.

These pension rules are encouraging employees to start making provision for their retirement - employers and government also contribute to make a larger pension pot.

Preparing for automatic enrolment

While staff may be automatically enrolled, there is still significant work for employers who need to prepare for the changes. For many employers, particularly small and micro employers, the introduction of automatic enrolment is a new and unfamiliar process. There are also many issues to communicate to employees who need to be informed about workplace pensions. There are specific requirements for employers to notify employees about what automatic enrolment means for them.

By the time that automatic enrolment has been phased in all employers will need to have a workplace pension (even if there is only one employee). Empirical evidence provided by larger firms, who have completed the enrolment process, concludes that automation of the various tasks associated with offering automatic enrolment is advised. This has ensured compliance with the rules and has minimised errors. This can be best achieved by ensuring that payroll or human resources software includes automatic enrolment functionality.

The timetable for employers to begin enrolling their staff started with larger businesses, followed by medium, and then small companies. It is expected that all employers will be part of the scheme by early 2018. The new rules only apply for the provision of pensions to employees, not the self-employed. The methodology for phasing in the scheme is known as 'staging'.

Staging dates

Staging dates are based on the size of an employer's PAYE scheme as at 1 April 2012 not the number of employees on the date that the automatic enrolment is due to start. The greater the number of people in the PAYE scheme (on that date) the earlier the staging date.

Employers can use a staging calculator provided by The Pensions Regulator to confirm their exact staging date. Most firms with less than 50 employees will have started the process between 1 June 2015 and finished by early 2018.

It is also possible, under certain circumstances, to bring forward or move back an employer's allocated staging date. The implementation of automatic enrolment is being staggered, in part, to ensure that the process is well managed and takes into account the time needed for businesses to adjust.

Contributions for automatic enrolment

Both the employer and employee need to make contributions to a pension scheme. There is a minimum employer contribution that will eventually reach 3%. Employers can make higher contributions if they so decide. Employees must also make contributions which are part funded by tax relief. By 6 April 2019, contributions in total will be a minimum 8%: 3% from the employer, 4% from the employee and an additional 1% tax relief.

The minimum contributions that employers must pay into their staff's pension scheme are shown in the table below:

Date	Employer minimum contribution	Total minimum contribution
Employer's staging date to 5 April 2018	1%	2%
6 April 2018 to 5 April 2019	2%	5%
6 April 2019 onwards	3%	8%

As the table shows, the employer's contributions are being phased in and start at 1% rising to 3% of staff's qualifying earnings. The qualifying earnings amount is set by the Department for Work & Pensions. There is no requirement to begin making contributions until after an employer's staging date.

For the current (2018-19) tax year this is set between £6,032 and £46,350 a year. This means that the first £6,032 of an employee's earnings isn't included in the automatic enrolment calculation. For example, if a worker earns £25,000 their qualifying earnings would be £18,968. The maximum amount contributions can be based on is £40,318 (£46,350 minus £6,032) for the 2018-19 tax year.

Enrolling employees

The law states that employers (after their staging date) must automatically enrol workers into a workplace pension if they are:

- Aged between 22 and state pension age.
- Earns more than minimum earning threshold (£10,000) per year.
- Work in the UK.
- Not already a member of a qualifying work pension scheme.

There are special rules for employees earning less than £10,000, who will usually have the right to opt in to the scheme, and employees aged less than 22 years and earning in excess of £10,000. It is important that employers are able to monitor any changes in employee ages and earnings so they can properly enrol any new or existing employees who become eligible at a future date.

It is also important that employers keep their staff informed throughout the automatic enrolment process, for example, by being told how much they will contribute and when.

Whatever their circumstances employers must make eligible employees active members of a pension scheme within a six-week period that starts on the date an employee first becomes eligible for automatic enrolment.

This could be:

- The employer's staging date.
- The day after their postponement period ends.
- The employee's first day of employment.
- The employee's 22nd birthday.
- When an employee starts to earn more than £10,000.

Setting up a qualifying scheme?

New employers need to check their staging date and start creating an action plan to prepare for enrolment. They will need to use software that can handle the requirements of automatic enrolment. This can usually be achieved by using their payroll systems. In addition, some pension providers may offer this service, although there may be additional costs.

Employers who do not have a pension scheme or want to change from an existing scheme will need to find a pension provider that offers an automatic enrolment scheme. Proper due diligence should be used to ensure that any scheme providers identified are well run and meet all the necessary legal requirements.

Most employers are likely to use schemes that are known as defined contribution (DC) schemes. This is because these types of scheme do not offer a fixed pension amount on retirement. This means that employers are only committed to paying a finite amount into the scheme.

Employers who already offer a workplace pension may not notice many changes, but there are significant changes for those employees that will be joining a work based pension for the first time. Employers need to check that any existing scheme is a qualifying scheme within the rules for automatic enrolment.

Accessing pension funds

Employees will usually be unable to access their pension's savings until they are 55. There are special rules for individuals that are seriously ill. They will also be able to have some choice over how risk sensitive they want their investments to be. There are also Sharia-compliant and ethical funds available.

Opting out of a pension scheme

Employers are not allowed to try and encourage employees to opt out of a pension scheme. This is known as 'inducement'. However, an employee is allowed to opt out of a pension scheme if they so wish. They will obviously lose out on valuable contributions from their employer and the Government.

There are certain rules which must be met in order to opt out of a pension scheme. In addition, employees will usually be re-enrolled again every three years or after starting a new job. If this happens and an employee still wishes to opt out, they will need to complete the opt-out process again.

There are safeguards in place to prevent employers from:

- Unfairly treating their employees because they decide not to opt out.
- Trying to advise staff to opt out.
- Not recruiting someone because they don't agree to opt out.

Penalties

There are many complex rules that employers must follow in implementing and running a pension scheme. If an employer fails to comply with their duties, the regulator may take enforcement action and issue an enforcement notice and /or a penalty.