Compulsory Pensions - Action Planning for Employers

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Since the Romans' amazing discovery, magnifying glasses have been used in countless endeavours, from studying cells to gazing at stars. Sometimes, it's only by scrutinising details that you can search out the most appropriate solution.

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Compulsory pensions are being introduced in the United Kingdom from 2012.

The employer's duty to enrol all employees automatically in a pension scheme is being rolled out in stages based on size of employer. Employer size is calculated by reference to PAYE payroll numbers as at 1 April 2012. The largest employers will be obliged to enrol their staff in a pension scheme to which they contribute from October 2012.

Although changes were announced in November 2011, the starting point for the programme review is October 2012.

All the world's a stage

The date on which compulsory pensions first applies is known as the employer's "Staging Date". We have produced a table which allows you to check your Staging Date. This is available on www.ffw.com.

The Staging Date is a key concept in employer compliance. It is important to identify it at the start of project planning and then work backwards from it to take key decisions with enough time to determine the detail before implementation. It is possible to bring forward your Staging Date by providing one month's notice to the Pensions Regulator. Employers may wish to do this if they want to avoid a key busy period in their operations or to coordinate with flexible benefit scheme windows. However, a Staging Date cannot be moved backwards - it can only be brought forwards, so be careful.

The Government announced on 29 November 2011 that it is changing Staging Dates for all employers with less than 3000 employees. New Staging Dates for these should be announced in January 2012.

Project Planning

The main purpose of this note is to set out how far back in time an employer needs to start preparing for compulsory pensions. Some solutions will require new software or re-programming existing systems. An existing pension scheme may need amending. HR standard forms such as offer letters and new employee data forms will almost certainly have to be revised.

12 – 9 months before Staging: Structure and systems

There are a number of major decisions to be made to introduce compulsory pensions and some of these, once researched and decided on, could take more than six months to implement. Therefore we recommend that up to a year before Staging Date employers consider the following:

- Does your HR system accommodate automatic enrolment, allowing you to keep records of employees who opt out and providing for re-enrolment automatically every three years? If you use external software is an upgrade included in your package or will you need to budget for new software programming?

- Will your payroll system be able to cope with compulsory contributions and calculation of qualifying earnings. The threshold for automatic enrolment is the same as for Tax, but the threshold for contributions varies.

- Do you have a flexible benefit system and when does this scheme year run from? Employees are likely to want to switch their options once they are enrolled in a compulsory pensions scheme and employers will want to take account of the cost increase. You will need to ensure that this either coincides with the start of a flexible benefit year or can be treated as a life event where salary sacrifice is used for employer contributions.

- Will you look to use your existing pension scheme as a "qualifying scheme"? We will have a separate briefing note on how to make your scheme a qualifying scheme, but you will probably need to amend your scheme on eligibility of employees (for instance if you have a waiting period), having a default investment option, abolishing application forms, changing minimum contribution levels or definitions of pay. Changing a pension scheme can take time, statutory consultation and agreement of the scheme's trustees.

6 months to go: HR audit

The next stage is to review employee communications including the staff handbook. We would advise that this takes place about six months before your Staging Date. Of course, to finalise the content of those communications you need to know whether, for instance, you are using your existing scheme as a qualifying scheme or using an external provider's scheme.

You cannot provide for employees to opt out before they are enrolled in their scheme. Employers cannot give out opt out forms but an opt out form is only valid if given to the employer within the first month of membership. On the other hand, you will need new opt-in forms as some workers who are not eligible for automatic enrolment will have a right to join your qualifying scheme.

Salary sacrifice can be used for pension contributions but it must be an optional employee choice. Because salary sacrifice requires employee written consent the salary sacrifice form is a barrier to enrolment so the enrolment would not be automatic.

Nothing in your recruitment procedures or benefit packages should be an inducement to any employee or employee to opt out of the scheme. This "inducement" ban causes some difficulty for employers who operate flexible benefit packages where pension contributions may be an option to be traded for, for instance, enhanced holiday entitlement. Unless it is clarified more specifically by the government or Pensions Regulator our advice is that employers should structure the minimum compulsory contributions as being outside the flexible benefit package so that these cannot be exchanged for other benefits.

3 months to go: Looking at individual cases

In the three months running up to your Staging Date we recommend that you review the position of any individual employees who may need special treatment.

For instance, if you have long serving or high earning employees who have fixed protection of their accrued pension for tax purposes you should ensure that they understand that staying in their pension scheme when compulsorily enrolled is likely to have serious tax consequences for them.

Case study

The Chief Executive of chain of clothes shops has a pension pot of £1.8 million built up over 30 years. In 2011 she registered for "Fixed Protection" so that the new lifetime allowance of £1.5m did not apply to her from April 2012. But Fixed Protection is lost if she accrues benefits in the employer's scheme. The employer company needs to be very careful that it is not seen as inducing her to leave the compulsory scheme but the tax consequences of staying in will be expensive. An appropriate solution may be for the employer to supply her with independent financial advice (which may be a taxable benefit).

Employees with fluctuating pay can cause issues as some weeks or months they will be below the threshold for automatic enrolment and other weeks and months they will be above the threshold. The legislation will allow for a smoothing of remuneration but employers will have to check this on an annual basis.

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Deduction of pension contributions from the pay of someone who is paid at minimum wage levels should not normally be a problem as the minimum wage applies to the gross remuneration before employee pension contributions. However employer contributions cannot be taken into account and so must be paid additional to the minimum wage. Further, employers who have agreed to their own level of minimum wage (such as the London Living Wage) will need to check the terms of their agreement to see whether employee and employer contributions are inside or outside the calculation basis.

After the Staging Date – the end of the beginning

Once an employer passes its staging date, automatic enrolment will become an HR and payroll process for new hires. Special provisions need to be made for monitoring pay levels for those who start below the threshold but then exceed it later in their careers.

When employees opt out they must be re-enrolled automatically every 3 years. HR and/or payroll systems will need to monitor this – employers have a statutory duty to keep records for inspection by the Pensions Regulator. Some administrative details will be simplified – so if an employee joins just before the 3 year point and opts out, he will not need to opt out again.

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