



LUCAS FETTES
& PARTNERS

PENSION REFORM BULLETIN 2.

In Bulletin 1 we explained the definition of a worker and with the forthcoming workplace pension reforms, which workers will need to be auto-enrolled. We now turn to the rationale behind why these contributions need to be made and how much employers will be compelled to pay for their workers. In this Bulletin we continue to focus on the new rules for employers using defined contribution arrangements.

The Inevitable Employer Contributions

Since workplace pensions began, employers have had the freedom to decide what type of arrangement to use, which workers to include and how much to pay in, if anything.

Now, after decades of legislative change and product development, the workplace pension domain is about to be injected with its first dose of contribution compulsion.

Lets just remember that employers have never been required to pay into pensions for their workers, unless it was contractual. Back at the start of this century, the Labour government knew longevity was increasing and over time, welfare costs would rise significantly - in hindsight, then would have been a much better time to introduce a mandatory contribution rate within workplace pensions. Instead, stakeholder rules were introduced for employers in 2001 with a view to encourage greater workplace pension savings for individuals on low to middle incomes. Unsurprisingly the legislation had little impact on its target group. Although employers were required to set up a scheme for their workers to join - very few actually paid anything in to it.

So the Pensions Act 2008 set out proposals to go much further than mere encouragement and three years on, these intentions have now been ratified in the Pensions Act 2011.

When will mandatory contributions start from?

Each employer will be given a staging date, this being the point when their new duties commence. Each employers staging date will be based on the size of their workforce (and for smaller employers their PAYE reference) as at 1st April 2012.

The original plan was to phase staging dates in over a period of four years with the largest employers starting in October 2012 and the smallest signed up by September 2016. However in a recent statement, the Government have confirmed that the staging date for small to medium sized employers will be delayed due to the prevailing economic climate.

Employers with 50 or fewer workers will see their staging date pushed back until the next parliamentary session whereas employers with between 50 and 3000 workers could see just a slight adjustment in their staging date.

A new timetable will be published shortly setting out the details of the revisions to staging dates.

Beyond their staging date, employers will need to be able to regularly capture, assess and report the profile of their workforce. Recruitment, pay reviews and increases in age could all trigger an event upon which the employer must act.

How much will employers have to pay in?

There will be a number of contribution options available for employers.

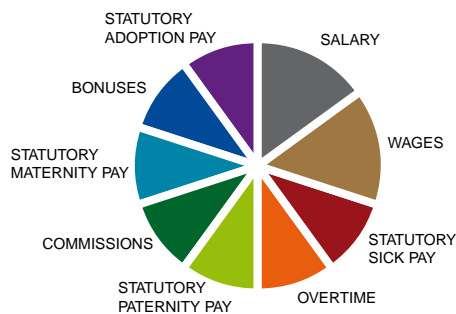
This includes a minimum contribution basis, based on 'qualifying earnings'. Every employer must adopt this approach unless they choose to / or already operate with a more generous contribution rate.



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Qualifying Earnings

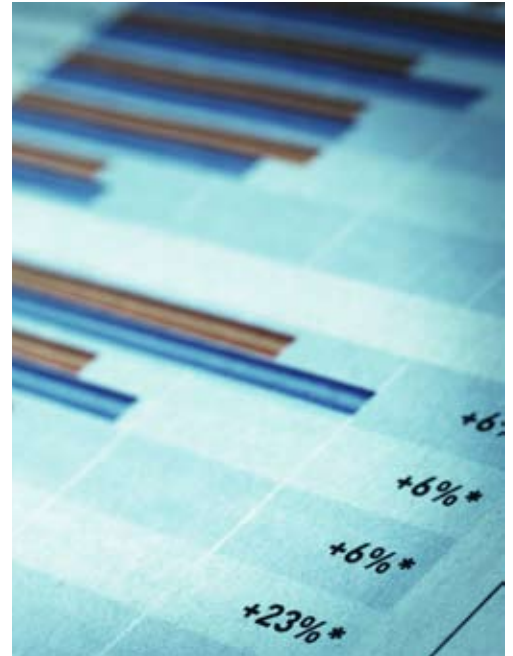
Qualifying Earnings are defined as earnings that fall in the £5,035 to £33,540 band (in 2006/2007 terms) and includes the following elements of pay:



A total of 8% of these earnings must be paid into a workplace pension for all eligible jobholders (see our Pension Reforms Bulletin 1), with at least 3% being paid by the employer. Where employers adopt the minimum rate, employees will be required to pay 5% (of which 1% is tax relief).

Calculating a contribution rate on the qualifying earnings basis is somewhat complex and may prove to be unworkable for larger organisations.

Many employers with existing workplace pension schemes base contributions from the first pound of earnings (rather than from a defined band). They are also unlikely to include all elements of pay within the definition of qualifying earnings.



Certified Schemes

As an alternative to the banded earnings basis, employers can certify their scheme by operating a more generous contribution rate. Although this may mean higher contribution amounts, using certification represents a better offering to workers and would serve to lower the costs associated with compliance and administration.

| | |
|------------------------|--|
| <p>Option 1</p> | <p>The total contribution must amount to at least 9% of pensionable pay (i.e. basic pay) in total. At least 4% must be payable by the employer.</p> <p>An example of this would be where an employer pays contributions for each eligible employee based on 9% of basic pay. The minimum employer contribution rate is 4% meaning employees would have to pay at least 5%.</p> |
| <p>Option 2</p> | <p>The total contribution must amount to at least 8% of pensionable pay as long as pensionable pay amounts to at least 85% of the aggregate of pay across eligible employees.</p> <p>In this example, an employer who pays employees basic pay plus sales-related commission can certify their scheme with contributions based on basic pay only, providing any sales-related commission makes up no more than 15% of total pay. The 15% figure can be taken as an aggregate across the eligible employees. On this basis, the minimum employer contribution rate is 3% meaning employees would have to pay at least 5%.</p> |
| <p>Option 3</p> | <p>The total contribution must amount to at least 7% of total pay. At least 3% must be payable by the employer.</p> <p>Here, an employer who pays basic pay plus overtime and an annual bonus can certify their scheme providing contributions for each eligible employee are based on 7% of total pay (basic plus overtime and bonus). The minimum employer contribution rate is 3% meaning employees would have to pay at least 4%.</p> |

With all variations, personal contributions will attract basic rate tax relief at source. Higher rate tax relief may be available, depending on each individual's marginal rate of tax. For the certified options, qualifying earnings can be ignored.

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Phasing

To help employers adjust gradually to the cost of compulsory pension payments, the contribution rate was to be phased in over a period of three years. The original timetable (see table below) sets out the qualifying earnings basis, which by 2017, would reach the 8% total rate.

| | Employer | Employee | Tax Relief | Total |
|-----------------------|----------|----------|------------|-------|
| Up to 10 / 2016 | 1.0% | 0.8% | 0.2% | 2% |
| 10 / 2016 - 10 / 2017 | 2.0% | 2.4% | 0.6% | 5% |
| 10 / 2017 Onwards | 3.0% | 4.0% | 1.0% | 8% |

The Department of Work and Pensions have confirmed that this timetable is now likely to be put back due to the delayed staging dates for small and medium businesses.

Summary

As we draw ever closer to this new age of compulsory contributions, employers will need to familiarise themselves with how the new rules will impact them so they can decide how to approach their duties. They will need to ascertain what the additional costs are likely to be both in terms of contributions, compliance and administration so these can be factored into their budgets.

These aspects will be of particular significance to employers who currently make no workplace pension provision for their workers.

In our next Bulletin we look at the types of pension scheme which will be available for employers to invest the compulsory contributions into and how they differ from one another.

Do you need more information or guidance?

For a full review of your current arrangements or for further information on how the forthcoming changes will affect you, please email us at pensionreform@lucasfettes.co.uk or call us on 0845 357 8910.