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pay, pensions and
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The Local Government Pensions Committee
Secretary: Terry Edwards

CIRCULAR

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No. 233 - DECEMBER 2009

WORKPLACE PENSIONS REFORMS

Purpose of this circular:

1. Part A of this Circular provides information on the workforce pension reforms that, subject to statements in the Pre-Budget Report of 9 December 2009, are due to come into effect from 2012. Part B sets out the potential implications these may have for the LGPS, administering authorities and for employers participating in the LGPS.

PART A

Background

2. As has been well publicised, people are living longer. They therefore need to plan and save for their later years. To encourage more people to do so the Government intends to introduce workplace pensions reforms from 2012.

3. The Pensions Act 2008 (the Act) sets out the framework for these reforms, with the detail being left for subsequent regulations.

4. In March 2009 the Government consulted on the first set of draft regulations – *The Pensions (Automatic Enrolment) Regulations 2009* and *The Pensions Regulator (Delegation of Powers) Regulations 2009*.

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5. On 24 September 2009 the Government published its response to comments made on those draft regulations and issued a further consultation document – *Workplace Pensions Reform – Completing the Picture* - together with six sets of draft regulations and various guidance notes.

6. This Circular is based on those consultation documents, guidance notes and draft regulations as they currently stand. It should be noted, however, that the draft regulations may be subject to further amendment as a result of responses to the consultation. They could even be subject to major overhaul, deferral or, indeed, never see the light of day post the 2010 general election depending on the views of any new, incoming, Government.

Staged process for employers to be brought into the automatic enrolment regime

7. Starting from October 2012, employers will be required to automatically enrol all eligible jobholders into a qualifying workplace pension and to make minimum contributions to it. The requirement will be phased in over a 3 year staging period. It is currently anticipated that, broadly speaking, large and medium sized employers will be staged in over the first year with small and micro employers being brought in over the following 18 months to 2 years. To make sure that the changes work in practice, a randomly selected group of employers with fewer than 50 workers will be subject to the requirements earlier than the vast majority of small employers.

8. Employer size will be determined using PAYE data from Her Majesty's Revenue and Customs (HMRC).

9. The Pensions Regulator will write to all employers individually at around 12 months before, and again at 3 months before, their automatic enrolment start date (i.e. their staging date) to inform them when they need to take action and what they need to do in order to comply.

10. If an employer wishes to bring forward their automatic enrolment start date they will have to seek permission from The Pensions Regulator.

Who will need to be automatically enrolled?

11. From their auto-enrolment start date (see paragraphs 7 to 10 above), and subject to the provisos in paragraphs 12, 28 and 30 below, employers will need to auto-enrol into a qualifying workplace pension scheme all jobholders working in Great Britain who are aged at least 22 years old and under State Pension Age and who are earning more than £5,035[1] a year.

12. However, the draft regulations allow employers to postpone automatic enrolment for a period of up to 3 months where they offer high quality

[1] The earnings figures are in 2006/07 terms and will be updated for 2012. The earnings figures are due to rise in line with the general level of earnings in Great Britain.

pension schemes[2] after which they must auto-enrol the jobholder into that scheme. It is proposed that this exemption should not apply to jobholders with short-term contracts of less than 3 months. They would have to be auto-enrolled immediately.

13. If the employer wishes to use a qualifying occupational pension scheme for auto-enrolment they must, by no later than the end of one month beyond the automatic enrolment date, have made an arrangement with the trustees or managers of that scheme to enable the jobholders to be auto-enrolled from the automatic enrolment date.

14. If the employer wishes to use a qualifying personal pension scheme for auto-enrolment they must have entered into an arrangement with the provider of that scheme so that, within one month of the auto-enrolment date, the jobholder is provided with information on the terms and conditions of the arrangement so that the jobholders can be auto-enrolled from the automatic enrolment date.

Where a jobholder is to be automatically enrolled, what information must be provided to the jobholder and to the trustees or managers of the scheme?

15. Within one month of the automatic-enrolment date, the employer must give the following information to the jobholder in writing:

    (a) a statement in the following terms 'You have been or will be automatically enrolled into a pension scheme to help you to save for your retirement';
    (b) the jobholder's automatic enrolment date;
    (c) the name, address, telephone number and electronic contact details of the scheme in respect of which the jobholder is or will be an active member;
    (d) the value of any contributions payable to the scheme by the employer (see paragraph 74 below) and the jobholder in any relevant pay reference period (see paragraphs 32 to 34) expressed as a fixed amount or a percentage of any qualifying earnings or pensionable pay due to the jobholder in the relevant pay reference period (including details of any changes due to the contribution rates to a defined contribution or personal pension arrangement during the transitional period – see paragraph 29);
    (e) a statement that any contributions payable to the scheme by the jobholder have been or will be deducted from any qualifying earnings or pensionable pay due to the jobholder in any relevant pay reference period (see paragraphs 32 to 34);

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[2] i.e. a personal pension scheme or money purchase scheme where the employer contribution is at least 6% of qualifying earnings and the total contributions, including the jobholder's contributions, are at least 11% of qualifying earnings in any relevant pay reference period; or a defined benefit scheme that meets the quality criteria; or a hybrid scheme where the respective elements of the hybrid scheme meet the aforementioned criteria for money purchase and defined benefit schemes.

(f) confirmation as to whether tax relief is or will be given in accordance with section 192 (relief at source) or 193 (relief under net pay arrangements) of the Finance Act 2004;
(g) a statement that the jobholder may remain an active member of the scheme without employer interference unless the jobholder is or becomes an active member of another qualifying scheme;
(h) a statement that the jobholder has a right to opt out of the scheme during the opt out period (see paragraphs 18 and 19);
(i) a statement indicating the start and end date of the opt out period applicable to the jobholder, where that information is known to the employer prior to the employer giving the enrolment information to the jobholder;
(j) the source from which the opt out notice may be obtained;
(k) a statement that opting out means that the jobholder will be treated for all purposes as not having become an active member of the scheme on that occasion;
(l) a statement that after a valid automatic enrolment opt out notice is received by the employer, any contributions paid by the jobholder will be refunded to the jobholder by the employer;
(m) a statement that where the jobholder opts out they have the right to subsequently opt in, in which case the employer will be required to arrange for that jobholder to become an active member of an automatic enrolment scheme once in any 12 month period;
(n) a statement that after the opt out period (see paragraphs 18 and 19) the jobholder may cease to make contributions towards their pension in accordance with scheme rules;
(o) a statement that a jobholder who opts out or who ceases active membership of the scheme [but remains in employment with the employer] will be automatically re-enrolled into an automatic enrolment scheme by the employer in accordance with regulations made under section 5 (automatic re-enrolment) of the Act;
(p) a statement giving details of where to obtain further information about pensions and saving for retirement.

Notes: In our response to the draft regulations we have said:
With regard to (b) above, does this have to specify a date (e.g. the specific date the jobholder commenced, such as 1 August 2012) or will it be acceptable for the information to be set out in generic terms (e.g. in the scheme guide sent to the jobholder, it explains that jobholders are auto-enrolled into the scheme from the first day of employment")? Similarly, for (i) above, does this have to specify specific dates or will it be acceptable for the information to be set out in generic terms?

16. Also within one month of the auto-enrolment date, the employer must give the following information in respect of the jobholder to the trustees or managers of the qualifying occupational pension scheme or the provider of the qualifying personal pension scheme:

(a) name;
(b) date of birth;

(c) postal residential address;
(d) gender;
(e) automatic enrolment date;
(f) national insurance number (and, if not immediately available, the employer must provide it to the trustees, managers or providers of the scheme within 1 month of the employer receiving it);
(g)*the value of gross earnings due to the jobholder in any relevant pay reference period (if this information is available to the employer);
(h)*postal work address;
(i)* individual work e-mail address, (if an individual work e-mail address is allocated to that jobholder);
(j)* personal e-mail address (if the employer holds this information).
(k)*the value, if any, of contributions payable by the employer and the jobholder in any relevant pay reference period (see paragraphs 32 to 34), expressed as a fixed amount or a percentage (see paragraph 74 below).

Note*: the employer does not have to supply those items marked with an asterisk if the scheme trustees, manager or provider confirm they do not require the information.

Can jobholders who are automatically enrolled opt out of the qualifying pension scheme?

17. Yes. To do so, the jobholder must complete and return a valid opt out form (using only the standard opt out form set out in the draft regulations). The jobholder can only obtain the form from the scheme trustees, managers or providers (not from the employer) and can only do so after they have been auto-enrolled.

18. Where the qualifying scheme is an occupational pension scheme, the form has to be returned to the employer within one month of the later of the date they became an active member of the scheme or the date they were provided with the information under paragraph 15.

19. Where the qualifying scheme is a personal pension scheme, the form has to be returned to the employer within one month of the later of the date the jobholder was provided with information on the terms and conditions of the personal pension or the date the employer provided the jobholder with the information under paragraph 15.

20. The employer must notify the trustees, managers or providers of the pension scheme that a valid opt out form has been received and refund to the jobholder any contributions deducted from the jobholder's pay. The trustees, managers or providers of the pension scheme must also refund to the employer any jobholder and employer contributions paid over to the scheme in respect of that jobholder.

21. It should be noted that a jobholder who misses the one month opt out period can still opt out at any time thereafter in accordance with the rules

of the relevant occupational or personal pension scheme. In such cases, the rules of the relevant occupational or personal pension scheme will determine what benefits / refunds are payable.

Do optants out have to be periodically re-enrolled?

22. Yes. The Pensions Act 2008 places a duty on employers to periodically re-enrol jobholders who have opted out.

23. It is proposed that optants out should be automatically re-enrolled on the third anniversary of the employer's staging date (see paragraphs 7 to 10 above) providing the jobholder has continued to work for the same employer and has not opted out within the previous 12 months.

24. The processes to be followed for re-enrolment are largely the same as for automatic enrolment.

What about jobholders who are not eligible for auto-enrolment?

25. These fall into two categories.

26. The first category is jobholders aged 16 or over and under age 22, or who have attained State Pension Age but are under age 75, and who are earning more than £5,035[1] a year. They will be able to notify their employer in writing that they wish to opt into their employer's qualifying workplace pension scheme and they will qualify for the compulsory minimum employer contributions. Employers will be required to provide these jobholders in writing, within one month of them becoming eligible within this category, with:

    (a) a statement that they may, by notice, require the employer to make arrangements for the jobholder to join an automatic enrolment scheme;
    (b) a statement that the opt in notice must be in writing and be signed by the worker and where the notice is in an electronic format, include a statement confirming that the jobholder personally submitted the notice;
    (c) a statement that the opt in notice must be given to the employer;
    (d) where the jobholder may become an active member of a money purchase scheme or a personal pension scheme -
    (i) a statement that the jobholder may receive a contribution to the pension scheme from the employer and the value* of that contribution in any relevant pay reference period (see paragraphs 32 to 34), and
    (ii) the value* of the contributions which the jobholder will be required to make in any relevant pay reference period (see paragraphs 32 to 34); and
    (e) details of where to obtain further information about pensions and saving for retirement.

Note*: "the value" of contributions may be expressed as a fixed amount or a percentage of any qualifying earnings or pensionable pay due to the jobholder in any relevant pay reference period (see paragraphs 32 to 34).

Where such a jobholder opts to join the qualifying pension scheme, the employer must, unless the job holder rescinds the election, comply with the provisions in paragraphs 15 and 16 above, but the automatic enrolment date will be the first day of the jobholder's relevant pay reference period (see paragraphs 32 to 34) after the employer receives the opt in notice or, if the payroll for that period has closed, the first day of the following pay reference period.

27. The second category is workers earning £5,035.00[1] a year or less. They will be able to notify their employer in writing that they wish their employer to enter them into a tax registered pension scheme which can be, but doesn't have to be, a qualifying scheme. Their employer will not be required to make a contribution, but may do so if they wish. The employer will be required to provide these workers in writing, within one month of them becoming eligible within this category, with:

(a) a statement that the worker may, by notice, require the employer to make arrangements for the worker to join a pension scheme;
(b) a statement that a joining notice must be in writing and be signed by the worker and where the notice is in an electronic format, include a statement confirming that the worker personally submitted the notice;
(c) a statement that the worker may, in accordance with the scheme rules, choose how much to contribute to the pension scheme; and
(d) details of where to obtain further information about pensions and saving for retirement.

Where such a worker opts to join the pension scheme, the employer must enter the worker into the pension scheme and provide the trustees, managers or providers of the scheme with the information in items (a) to (k) of paragraphs 16 above. The employer does not have to supply those items in paragraph 16 that are marked with an asterisk if the scheme trustees, manager or provider confirm they do not require the information.

What about jobholders who, at the automatic enrolment date, are already a member of a scheme that meets the requirements for being a qualifying scheme?

28. Such jobholders will remain in membership of the existing scheme but the employer will, within two months of what would have been the automatic-enrolment date, have to provide the following in writing to the jobholder:

(a) the name, address and electronic contact details of the scheme of which the jobholder is an active member;

(b) confirmation that the scheme in which the jobholder is an active member is a qualifying scheme;
(c) that the jobholder may remain an active member of that qualifying scheme without employer interference unless the jobholder is or becomes an active member of another qualifying scheme.

Note: in our response to the draft regulations we say:

This has the distinct possibility of suffering from the law of unintended consequences. Our concern is that if all existing scheme members are sent a notice explaining that they are entitled to remain in the scheme without interference from the employer, this will, far from reassuring them, inevitably raise concerns. In other words, regardless of how such a notice is worded, the members will worry that there is some other underlying, but unspoken, reason for the employer writing to them – "Why is my employer writing to me? Is my pension scheme in financial trouble? There must be something going on, else why write to reassure me?"

What is the minimum contribution employers must pay into a qualifying pension scheme?

29. Employers using a defined contribution scheme as the qualifying pension scheme (see paragraphs 36 to 42) will be required to pay an employer contribution of 1% of an eligible jobholder's earnings between £5,035[1] and £33,540[1] until staging is complete, with the total contributions amounting to at least 2% (i.e. 1% from the employer plus a minimum of 1% from the jobholder, including tax relief). In the following year, the total contribution increases to a minimum of 5%, including an employer contribution of 2%. Then the next year, the total contribution must be at least 8%. This will be made up of the jobholder's own contribution of 4%, around 1% in the form of tax relief, and 3% from the employer.

30. Employers using a defined benefit scheme or a hybrid scheme as the qualifying pension scheme (see paragraphs 36 to 42) will be able to delay automatic enrolment until the end of the 3 year staging period, but only for those existing jobholders who, at the employer's staging date (see paragraphs 7 to 10 above), were eligible (and continue to be eligible) for membership of the employers' qualifying pension scheme. Any new jobholders taken on after the employer's staging date will have to be automatically enrolled into the employer's qualifying pension scheme.

31. If an employer who has chosen to delay automatic enrolment into a defined benefit scheme closes that scheme during the 3 year staging period, the employer will have to enrol their jobholders into an alternative qualifying pension scheme. Where that alternative scheme is a defined contribution scheme, the employer will have to pay contributions back to what would have been the original automatic enrolment date, which could amount to up to 3 years' worth of back contributions.

How can an employer check whether a jobholder's earnings exceed the earnings threshold for being eligible for automatic enrolment into the employer's qualifying pension scheme?

32. Where a jobholder has regular earnings it will be comparatively straight forward for the employer to determine, for the purposes of auto-enrolment[3], whether the person's earnings exceed £5,035[1] and, where they do, the contributions due on their earnings between £5,035[1] and £33,540[1].

33. However, some workers have fluctuating earnings. For these workers it is proposed that there should be a "pay reference period". This will be the period over which the jobholder receives his / her regular wage or a period of one week and is used to determine whether the pay in that period will trigger automatic enrolment and the amount of contributions payable.

34. For jobholders with casual earnings who may, exceptionally, earn enough to gain jobholder status for isolated pay periods but may not earn enough to exceed the £5,035[1] threshold for the whole year, the pay reference period will be 12 months. If their earnings in the pay reference period are less than the threshold they will not be automatically enrolled.

35. A 12 month pay reference period will also be used for employers using a defined contribution scheme to determine whether that scheme meets the test for a qualifying pension scheme (see paragraphs 36 to 42) and to allow the employer, at the end of the year, to assess whether pension contributions paid meet the minimum level requirements (see paragraph 29).

Which scheme(s) can employers use as a qualifying pension scheme?

36. Employers will be able to choose the pension scheme(s) they want to use, including their current scheme(s), provided the scheme(s) meet certain quality criteria (see next section).

37. A new, simple, low-cost pension scheme – currently known as the personal accounts scheme – will be introduced as one such qualifying scheme. This will be launched in time for employers to use it from the commencement of employer duties under the Act in 2012.

38. A scheme which provides for average salary benefits will not be a qualifying scheme if there is no provision for the average salary benefits to be revalued, or if there is a discretionary power to revalue the benefits but the discretion is exercisable otherwise than by the trustees or managers of the scheme or is exercisable by the trustees only with the consent of the employer.

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[3] Subject to the jobholder being at least 22 years old and under State Pension Age.

What are the quality criteria for a scheme to be a qualifying pension scheme?

39. The quality criterion for a defined contribution scheme is that the scheme must require the equivalent of an 8% contribution on qualifying earnings[4] between £5,035[1] and £33,540[1], of which the employer must pay at least 3%. This is subject to the phasing in period (see paragraph 29).

40. The quality criterion for a defined benefit scheme is that the scheme must either have a contracting-out certificate in force (i.e. it meets the reference scheme test for a scheme to be contracted-out of the State Second Pension Scheme) or it must meet the test scheme standard.

41. The test scheme standard for a defined benefit scheme is that the scheme provides a pension at age 65[5] (payable for life) that is not less than 1/120th of average qualifying earnings in the last 3 tax years preceding the end of pensionable service multiplied by the number of years of pensionable service (up to a maximum of 40 years).

42. A pension under the test scheme standard for a defined benefit scheme must satisfy the requirements of section 84(1) of the Pension Schemes Act 1993 (revaluation by final salary method of benefits in the case of scheme members who leave pensionable service before attaining normal pensions age) and satisfy the requirements of section 51 of the Pensions Act 1995 (indexation of pensions).

How will employers certify their scheme(s) meet the quality criteria?

43. A certification process is proposed to allow employers to certify that the scheme they use meets the quality criteria.

44. This will be relatively straightforward for a defined benefit scheme i.e. that there is a contracting-out certificate in force in relation to the scheme or that the scheme meets the test scheme standard. No-one other than the scheme actuary or the employer can certify that a scheme meets the test scheme standard (and an employer may only do so in cases that do not require any calculation, comparison or assessment which is usually carried out by actuaries). In determining whether the scheme meets the test scheme standard, the employer or scheme actuary must not take into account a number of benefits including: pension credit benefits; death benefits; discretionary benefits (apart from discretionary pre-retirement revaluation increases in average salary schemes); survivor benefits; and money purchase benefits. The scheme cannot be certified if the pensions to be provided to more than 10% of the scheme members fail the test scheme standard.

[4] Qualifying earnings includes salary, wages, commission, bonuses, overtime, statutory sick pay, statutory maternity pay, statutory paternity pay and statutory adoption pay.
[5] The pension age for the test scheme rises to 66 from 6 April 2024, 67 from 6 April 2034, and 68 from 6 April 2044.

45. For defined contribution schemes, the process allows the employer to continue to calculate pension contributions on their definition of pensionable pay and certify that they are on track to meet the quality requirements over the course of the life of the certificate. They will need to review the certificate at the end of the life of the certificate to make sure the scheme did meet the quality requirements. Given that the definition of qualifying earnings[4] includes items that may not fall within the definition of pensionable pay in the employer's defined contribution scheme (e.g. overtime) there may be cases where the contributions paid do not meet the minimum contributions due on qualifying earnings between£5,035[1] and £33,540[1]. Employers will not, however, be required to make retrospective contribution payments provided that the shortfall does not exceed 5% of their expected minimum contributions, that no more than 10% of jobholders in the scheme suffer a shortfall, and that no jobholder suffers a shortfall more than once in 2 consecutive years.

46. Hybrid schemes will, in some cases, need to meet the quality requirements for money purchase schemes or defined benefit schemes and, in other cases, meet a combination or modified version of these. Guidance notes have been created to help employers with hybrid schemes.

47. If an employer wishes to use a non-UK scheme as a qualifying workplace pension scheme, that scheme will need to meet the quality test and will also have to provide an income in retirement and be regulated by a regulatory body. Contributions totalling the full 8% of qualifying earnings will have to be paid, whether the non-UK scheme is eligible for UK tax relief or not.

48. The certificate lasts for 12 months, or such shorter period as determined by the employer or, if earlier, the date a scheme is wound up or the employer determines the scheme can no longer meet the quality requirements.

Apart from certifying the scheme meets the quality test, does the employer also have other responsibilities and are there obligations placed on the trustees, managers or providers of the qualifying pension scheme?

49. Yes. These are detailed below.

Registration

50. **Employers** will be required to register with The Pensions Regulator within 9 weeks of their staging date (see paragraphs 7 to 10 above) and every three years thereafter. It is proposed that employers will have to provide The Pensions Regulator (TPR) with:

    (a) information that enables TPR to identify and contact them;

(b) information about the action they have taken to enrol their jobholders into pension saving, and details of those jobholders who have opted out;
(c) where they do not have to enrol individuals into pension saving, why this is the case – for example, whether those people are outside the age bands for automatic enrolment, are subject to postponed automatic enrolment, or were already in a qualifying scheme;
(d) information about their pension arrangements, which will enable TPR to link the employer to the pension scheme they have chosen. This will include providing a reference to enable TPR to match the employer with their pension arrangement. TPR guidance will help employers identify the right reference to use.

Record keeping

51. **Employers** be required to keep records as set out in the draft regulations, including records relating to the pension arrangements they have made, which jobholders have been enrolled and when, copies of any opt in and opt-out forms, the gross earnings of each scheme member in each pay reference period (see paragraphs 32 to 34), the pension contributions they have made and when they were paid over to the scheme. TPR will use these records where needed to check that employers have undertaken enrolment and opt-out correctly.

52. **Occupational pension schemes and pension providers** will be required to keep records of enrolments and opt-outs in respect of each employer, as well as information relating to individual scheme members and optants-out (such as name, date of birth, NI number, home address and post code). TPR will use these records to confirm enrolment and payment of contributions with the pension scheme or provider, and help identify prohibited behaviour such as employers inducing workers to opt out of pension saving.

53. The employer and the pension scheme will have to keep these records, apart from opt out notices, for a period of 6 years and TPR can require the records to be produced on request. Opt out notices only have to be kept until the jobholder’s next automatic re-enrolment date.

Employer duty to maintain active membership

54. **Employers** must make sure that jobholders remain active members of a qualifying pension scheme, unless a jobholder chooses to opt out.

55. An employer cannot force or induce a jobholder to opt out. Where an employer seeks to do so the jobholder will have up to 6 months from the alleged misdemeanour to complain to TPR.

56. Where an employer is changing their qualifying pension scheme, a one-month gap between membership of the old and new schemes is to be

allowed to give the employer some leeway to finalise arrangements with the new scheme.

Payment of contributions

57. Currently, employee contributions deducted from earnings have to be paid over to the scheme by the 19th of the month following that in which they were deducted.

58. This will continue to be the case going forward except for contributions deducted during the joining window and opt-out period (see paragraphs 18 and 19). Those contributions do not have to be paid over until the 19th day of the second month. This means that if the jobholder opts out in the opt-out period, the employer can refund the contributions and will not have to get contributions back from the scheme (as they will not by then have been paid over to the scheme).

59. If an employer fails to deduct contributions for some time, the Pensions Act 2008 provides TPR with discretionary powers which can be used in a compliance notice or unpaid contributions notice. It is proposed that if an employer fails to meet its obligations for a period of 3 months, TPR can require the employer to pay jobholder contributions as well as the employer contributions, together with interest on a simple per annum basis. Interest would be at the rate of 4.9% plus RPI.

Are there any other penalties?

60. Although its approach is intended to educate and enable in the first instance, TPR will have the power to issue fixed and, in some circumstances, escalating penalty notices in cases of non-compliance with employer duties.

61. A fixed penalty is intended as a prompt for **employers** who fail to engage with the workplace pensions reforms despite the provision of information and support. It is proposed the fixed penalty would be a sum of £500.

62. TPR can escalate this for entrenched non-compliance behaviour and issue increasing penalties that vary relative to the size of the employer's workforce. The penalties range from £50 a day for an employer with less than 5 workers up to £10,000 a day for an employer with 500+ workers.

63. **Third parties**, such as the trustees or managers of a pension scheme, payroll administrators, accountants, and pension administrators could become liable to a fixed penalty of £500 or escalating penalties of £200 per day. This could happen, for instance, if they have contributed towards an employer's failure to comply with the employer's duities.

64. There is a separate power for TPR to issue a fixed penalty notice where it believes an **employer** has contravened the 'prohibited recruitment

conduct' measure. This measure is designed to deter employers from trying to screen out of the recruitment process any job applicants who might want to save in a qualifying workplace pension. Where an employer has carried out prohibited recruitment conduct, it is proposed there should be a system of fixed penalties that vary by employer size. These range from £1,000 for an employer with less than 5 workers up to £5,000 for an employer with 250+ workers.

65. Anyone issued with a penalty notice will have up to 28 days from the date the notice was issued within which to apply for a review.

66. TPR will be able to initiate a review of a notice it has issued and will be able to do so up to 18 months from the date the notice was issued.

PART B

Implication for the local Government Pension Scheme (LGPS)

67. The LGPS is a defined benefit occupational pension scheme that has a contracting-out certificate in force (i.e. it meets the reference scheme test for a scheme to be contracted-out of the State Second Pension Scheme). As such it meets the quality criteria to be a qualifying occupational pension scheme for auto-enrolment.

68. However, employees with a contract of employment that is for less than 3 months are not presently eligible for membership of the LGPS. The draft auto-enrolment regulations propose that such jobholders are auto-enrolled into a qualifying pension scheme. This would have major implications for the LGPS or for employers participating in it. In our response to the draft regulations we made the following comments:

The LGPS currently does not permit employees with a contract for less than 3 months to join the scheme. This exclusion covers a range of types of employee, from the employee with a fixed term contract of, say, 2 months, to a casual employee who might only be an employee on the occasional days he / she works[6]*. The proposal that short-term workers with contracts of less than 3 months should be auto-enrolled into a qualifying pension scheme would mean that either:*

(i) *the LGPS would have to be amended to permit* ***all*** *such employees to be auto-enrolled into the scheme, or*

(ii) *the LGPS would have to be amended to permit such employees who are aged 22 or over and under State Pension Age and whose annual equivalent earnings are £5,035 or greater to be auto-enrolled and to permit those on less than £5,035, or who are aged between 16 and 21, or who are over State Pension Age and under age 75, to opt into the LGPS, or*

[6] Based on the House of Lords decision in Carmichael v National Power

(iii) *if no such amendments were made to the LGPS, all participating employers would have to auto-enrol such employees into some other qualifying scheme if they are aged 22 or over and under State Pension Age and have annual equivalent earnings of £5,035 or greater, and permit those on less than £5,035, or who are aged between 16 and 21, or who are over State Pension Age and under age 75, to opt into that qualifying scheme*[7]*.*

All three routes would add considerably to the administrative burden and, hence, costs placed on employers. For example:

(i) *if the first approach were to be taken by the LGPS, such employees on leaving with less than 3 months membership would have no overriding right under Chapter 5 of the Pension Schemes Act 1993 to a transfer value (or to a deferred benefit). The only overriding right is to a refund of contributions. To bring such employees into the LGPS, only to refund their contributions to them on leaving, is an administrative overhead that does not seem warranted.*
(ii) *if the second approach were to be taken it would suffer from the same drawback as the first plus the employer would have to determine which staff to auto-enrol and which to give the right to opt into the scheme. This would add considerably to the administrative burden and has the clear potential for mistakes to be made on the payroll.*
(iii) *if the third approach were to be adopted, not only would it suffer from the problems highlighted in (ii) above, but employers would have to operate two schemes whereas currently they only have to operate one. This would add considerably to the administrative burden and mistakes would be likely to occur on payroll, with employees being enrolled into the wrong scheme.*

We would strongly urge, therefore, that good quality defined benefit schemes (such as the LGPS) should continue to be permitted to exclude those with contracts for less than 3 months. Where the contract is extended beyond 3 months the employee should immediately be enrolled and given the option to backdate membership to the first day of the original contract. If an employer deliberately sets out to exclude an employee from membership by issuing a series of short-term contracts (each of less than 3 months duration with breaks in between), the employee should have the right to complain to the Pensions Regulator.

Implications for employers participating in the LGPS

69. The draft auto-enrolment regulations will have a number of implications for employers participating in the LGPS. Apart from the problem highlighted in paragraph 68 above, the implications for employers using the LGPS as the auto-enrolment scheme include:

[7] or into a tax registered pension scheme

- whether to postpone the automatic-enrolment date (see paragraph 12)
- the certification process (see paragraph 44)
- the registration process (see paragraph 50)
- the information and notification procedures (see paragraphs 15, 16, 26, 27 and 28)
- the need to auto-enrol jobholders. They can only opt out after they have been auto-enrolled (i.e. a jobholder cannot pre-notify the employer that they do not wish to be auto-enrolled – see paragraph 17). This seems overly stringent as it does not permit a person to notify his wish not to be a member prior to commencing employment and could result in unwelcome extra administration for employers, payrolls and schemes if the jobholder has to be enrolled, the payroll is run before the opting out form can be obtained, completed and processed, and the contributions have to then be refunded
- the periodic re-enrolment process (see paragraph 23)
- the record keeping requirements (see paragraphs 51 and 53)
- whether to delay pay-over of the first months contributions (see paragraphs 58 and 73)

70. Those employers who do not currently offer all their employees access to membership of the LGPS will need to give serious consideration as to how they are to meet their auto-enrolment obligations. These employers include admitted bodies providing access for some but not all of their employees, contractors with closed admission agreements, and designation (resolution) bodies who have designated some but not all of their employees for access to the LGPS. Such employers will have to decide whether to open up the LGPS to all staff in order to meet their auto-enrolment obligations in respect of those jobholders who are not currently offered membership of the LGPS or whether, instead, to offer a different qualifying scheme to those staff.

Implications for administering authorities

71. The draft regulations will have a number of implications for LGPS administering authorities too. These include:

- the communication strategy to make employers in their Fund aware of their obligations from 2012
- keeping track of the dates from which employers in their Fund come on stream under the auto-enrolment requirements (bearing in mind that employers of different sizes come on stream at different dates and some may choose to defer their auto-enrolment implementation date – see paragraph 12)
- the need to issue opt out forms (see paragraphs 17 and 72)
- the record keeping requirements (see paragraphs 52 and 53)
- how the pay-over of the first months contributions is to be managed / reconciled (see paragraphs 58 and 73).

72. In our response to the draft regulations we made the point that, in a multi-employer scheme such as the LGPS, requiring the scheme administrator to issue opt out forms, rather than the employer, could introduces an extra administrative burden on the scheme administrator, lead to additional administrative costs (particularly where administration has been outsourced, as the administrator may seek to charge extra for the additional work), and potentially creates delays for the jobholder (in having to go to a third party to obtain an opt out form rather than just getting one from the employer).

73. With regard to the pay over of the first months contributions we said:

For a defined benefit scheme, such as the LGPS, the suggestion that the scheme should refund to the employer, within the timescale set out in regulation 12 of the draft Automatic Enrolment Regulations, any employee and / or employer contributions in respect of a jobholder who has opted out is not a rational or cost effective approach. A further option should be permitted for defined benefit schemes whereby the employer can continue to pay contributions to the scheme within 19 days of the month in which they were deducted from pay and, if the employee then opts out, the employer simply reduces the next payover of employee / employer contributions to the scheme by the relevant amount.

Other concerns

74. The draft regulations specify that the employer should provide the jobholder and the pension scheme administrators with the value of any contributions payable to the scheme by the employer and the jobholder in any relevant pay reference period (see paragraphs 32 to 34) expressed as a fixed amount or a percentage of any qualifying earnings or pensionable pay due to the jobholder in the relevant pay reference period. In our response to the draft regulations we have set out our concerns that expressing employer contributions to a defined benefit scheme in this way is inappropriate. We said:

Providing employer contribution information in this form for a defined benefit scheme is, at best, somewhat irrelevant and, at worst, highly misleading. Let us take, as an example, two members of the Local Government Pension Scheme (the statutory regulations for which govern the 100 separate LGPS final salary, defined benefit schemes[8]). Both members commence employment on the same day and on the same starting salary. One is employed by Employer A and the other by Employer B, and both employers participate in LGPS Fund X. The employer contribution rate paid by Employer A is 10%, although the underlying employer rate is actually 14%. The rate is 10% because the employer's share of the Fund is currently in surplus. The employer contribution rate paid by Employer B is 20%, although the underlying employer rate is

[8] There are 3 schemes, one for England and Wales, one for Scotland and one for Northern Ireland. These are administered by 100 separate administering authorities.

actually 14%. The rate is 20% because the employer's share of the Fund is currently in deficit. If we show the employer contribution as an amount or a percentage of pay this could lead the employee of Employer B to think one of the following:

i) *"my pension benefit is worth much more than that offered by Employer A"; or*
ii) *"as my employer is having to put in twice as much in contributions as Employer A, perhaps my scheme and my benefits are at risk".*

In fact, neither is true. The value of the final salary pension benefit is exactly the same and, being a statutory scheme, the benefits are not in jeopardy.

Now let's assume that the employee of Employer B moves to Employer C. The employer contribution rate paid by Employer C is 15%, although the underlying employer rate is actually 14%. The rate is 15% because the employer's share of the Fund is currently slightly in deficit. However, on being informed of the 15% employer contribution rate one can hear the member saying "If I'd known that the employer is only paying three quarters of the contribution that my old employer paid, I wouldn't have taken the job". In fact, the value to the employee of the final salary benefit promise is greater, due to the increase in salary.

Thus, to give the value of employer contributions as a fixed amount or as a percentage of the jobholder's pensionable pay is clearly misleading. Also, what about those major public sector final salary schemes which are unfunded pay as you go schemes (e.g. the Police Pension Scheme) where there is no employer contributions per se? Should we show a nil contribution? This would itself be highly misleading as the employer meets the balance of the cost of paying out the benefits.

It is vitally important that, in trying to develop a strategy to inform people of the value of their pension rights and what the cost to the employer is, that a distinction is made between defined benefit and defined contribution schemes. Clearly, showing the employer contribution made to a defined contribution scheme is vitally important. It is not important in relation to a defined benefit scheme and, as shown above, can be positively misleading.

Quoting the employer contribution to a defined benefit scheme as an amount or a percentage of pensionable pay also suffers from the fact that it is inconsistent withother legislation and thus potentially misleading and confusing for scheme members. For example, valuing a benefit in one way for the purposes of the Automatic Enrolment Regulations, another for the HMRC Annual Allowance test, another for the HMRC Lifetime Allowance test, another for the purposes of the Accounts and Audit Regulations 2003 [SI 2003/533] (where there are propsals to disclose the value of benefits, including pensions, of senior officers in public bodies) and perhaps yet

another for the purposes of Total Rewards statements issued by employers, will be highly confusing for a scheme member.

When I met with DWP officials I was told that the regulations were to be amended in relation to defined benefit schemes so that the requirement would be to inform the jobholder of the accrual rate rather than the employer contribution. This seemed to be a sensible approach and suggest that either the draft regulations be amended accordingly or regulation 2 is amended to mirror regulation 18(2)(d) which only requires employers to provide the value of the employer contribution contribution if the scheme is a money purchase or personal pension scheme.

75. We also expressed our concerns over the potential costs associated with the auto-enrolment proposals and said:

    Based on a limited survey of 20 local authorities in 2003, approximately 36% of their employees chose not join the LGPS. The auto-enrolment of optants out every three years coupled with the proposed auto-enrolment of employees with contracts for less than 3 months could, therefore, potentially have a serious impact on pension on-costs for LGPS employers. The underlying employer contribution rate for the LGPS has been estimated by the Government Actuary as being 11.9% of pensionable pay for new entrants (although the current average employer contribution rate is nearer 15%). This would constitute a serious level of additional cost hitting hard pressed council budgets, potentially leading, in a worst case scenario, to job losses and / or reductions in delivery of front line services, unless additional funding is provided by central government. A similar scenario will, undoubtedly, apply in other areas of the public service e.g. the NHS, teaching, police, fire, etc although the numbers of employees not currently joining the Teachers', Police or Firefighters' pension schemes is, comparatively, relatively low. Have the DWP taken this into account in the impact assessment?

76. A copy of our full response to the consultation on the draft regulations is available on our website.

ACTIONS FOR ADMINISTERING AUTHORITIES

77. Administering Authorities are urged to copy this Circular to all employers in their Fund or bring the Circular to the attention of employers by directing them to it on the LGE website.

Terry Edwards
Head of Pensions
9 December 2009

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