Pensions Client Directorate

Executive Summary – Policy Narrative

Workplace Pension Reform – Completing the Picture

24 September 2009

Department for Work and Pensions

Contents

Part One – Introduction

1. Current estimates suggest that approximately 7 million people are not saving enough to deliver the pension income they are likely to want, or expect, in retirement. Most people aspire to more in retirement than the state can provide, yet an estimated 44 per cent of working age workers are not contributing to a private pension.

2. To counteract this under-saving the Government is introducing workplace pension reforms, legislated for in the Pensions Act 2008. The reforms will place new duties on employers to automatically enrol all eligible jobholders into a workplace pension arrangement, and to contribute to that arrangement at least 3 per cent of jobholders' qualifying earnings. These measures will transform pension saving in the UK: we estimate that 5-9 million people will be newly participating, or saving more, in workplace pensions as a result of the reforms.

3. But the Government cannot achieve these outcomes on its own. Individuals and employers also have their part to play, supported by a strong pensions industry. We want to support employers and pension schemes through this major change in the pensions landscape, and have aimed to **minimise the costs** associated with these reforms whilst maximising individuals' opportunities to save.

4. Further background on the reforms is available on the Department for Work and Pensions' website at www.dwp.gov.uk/policy/pensions-reform

5. The proposals outlined in this consultation document aim to help the right individuals enter the right schemes at the right time, whilst supporting employers and the pensions industry through this major change in the pensions landscape.

6. This consultation should be read alongside:

   - The Government response to the March 2009 consultation on automatic enrolment regulations.

   - The impact assessment, which estimates costs to employers arising from the regulations in this consultation document.

Delivering the reforms

7. It is crucial that the reforms **work operationally** and a key part of this is getting the critical introductory phase right. Our implementation strategy has been designed with this as its focus. Bringing in the duties in stages will aid schemes in managing the volumes of new members they will be required to administer during the implementation period. By staging in the employer duties by employer size - from the largest through to small and micro employers - we hope to **minimise the burden** on small and medium

businesses. We will also be phasing in the contributions gradually over time to give employers and jobholders who are new to pension saving **time to adjust** to the additional cost of making contributions.

Maximising individuals' saving opportunities

8. In the first consultation document[1] (March 2009) and Government response (published alongside this document) we dealt with getting people into pension savings through automatic enrolment. In this document, we consider arrangements for those individuals who choose to opt out, or for those for whom automatic enrolment is not appropriate at this time. We want to make it as **simple as possible** for these individuals to **enter pension saving when the time is right**, and ensure that the processes by which they can join a pension are simple for their employers. We also want all individuals to have **confidence in the continuity of pension provision**.

Maximising existing good provision

9. Our aim has been to allow **as many existing schemes as possible to meet the required standard**, thereby making it easy for employers who already have good schemes in place to meet the requirements and to **protect good existing provision**. We also want to make it as **simple as possible for the pensions industry to provide schemes of a sufficient quality,** and to keep a **level playing field** between occupational and contract-based schemes. In addition we need to make sure that the **schemes that individuals are enrolled into are of sufficient quality**. We have aimed to strike a delicate balance between these needs in the section on scheme quality which outlines the minimal quality criteria with respect to hybrid, defined benefit and non-UK schemes and discusses a simple defined contribution certification process.

Compliance

10. The Pensions Regulator (TPR) will be responsible for ensuring that employers meet their obligations. The aim of the compliance regime is to **support and help employers** who wish to fulfil their duties through **educating and enabling** them to do so. But where employers still fail to comply, TPR will be able to take enforcement action to **ensure a level playing field amongst employers** and to **protect individuals' savings**.

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[1] Pensions – Consultation on Draft Regulations, *The Pensions (Automatic Enrolment) Regulations 2009 and The Pensions Regulator (Delegation of Powers) Regulations 2009,* March 12 2009

Part Two – Delivering the reforms

Summary

This section covers the introduction of the duties, including how the duties will be gradually staged in via employer size; how this interacts with the phasing in of contributions for defined contribution schemes; and the deferment of automatic enrolment for defined benefit and hybrid schemes.

Implementation of the private pension reforms

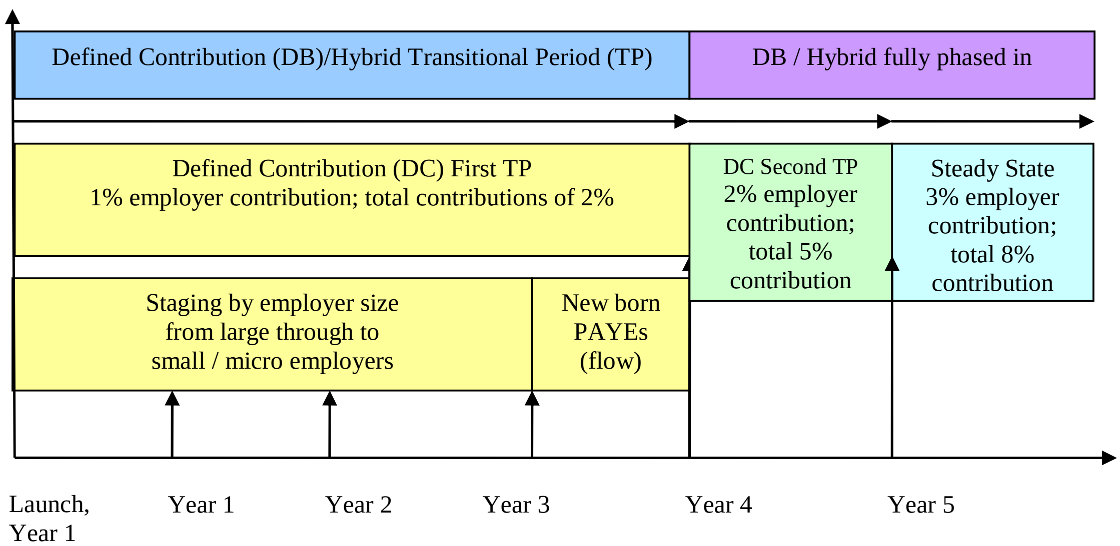
1. The Government has embarked on a radical reform of the private pension system in this country. Change on this scale will improve the lives of millions, but its success depends entirely on being able to make the policy work in practice - a huge challenge for the Department for Work and Pensions (DWP) and its delivery partners, the Pensions Regulator (TPR) and the Personal Accounts Delivery Authority (PADA).

2. It is important to remember that these reforms will have a hugely significant impact over the medium to long term and we should not judge their success solely on immediate results. It is far more important to get the right infrastructure and savings culture in place to ensure the sustainability of the reforms. **We are therefore proposing transitional arrangements after the launch of automatic enrolment to support smooth delivery and help employers adjust gradually to the reforms.** These are:

   - **Staging**: How requirements on employers will be introduced over time.

   - **Transitional arrangements** for defined contribution and defined benefit schemes.

Proposed Arrangements



Staging

3. The Government is currently planning to launch the reforms from October 2012. To ensure a smooth implementation we are planning to make regulations to stage in the application of the duties to different employers over time. This approach follows guidance set out by the Office of Government Commerce[2] which advocates a staged approach to large change programmes and will mitigate operational risks for DWP's delivery partners (TPR and PADA) and for scheme providers.

Length of staging

4. Following detailed consideration of the operational capacity of the two key delivery partners, **we believe it is necessary to stage the reforms, including the employer duties, over a 3-year period.** This strikes the right balance between getting people into saving as quickly as possible and minimising the operational risk associated with the reforms. At its peak, that would still mean around 100,000 employers being brought into the duties in one month. The 3-year period would include a number of 1-month breaks in which no employers are staged in, to allow any backlogs or unplanned events to be addressed.

5. The operational risk associated with the reforms arises from the combination of high levels of uncertainty and high volumes:

    - It is difficult to estimate how much support employers with no experience of pensions will require from TPR and the personal accounts scheme, and what sort of support employers will need (for example, e-channel or call centre support).

    - We expect that a significant group of employers will wait until the last moment to fulfil their obligations. TPR and PADA are therefore anticipating significant peaks of activity around the staging dates, which can only be managed by reducing the maximum number of employers in each group to a manageable number.

    - Because the volumes of employers and workers will be so large, estimates of call-centre capacity will be extremely sensitive to small changes in assumptions.

6. The challenge is particularly significant for the personal accounts scheme, given that we do not know how many employers and workers will choose to use it. Further, once staging has begun the scheme will not be able to turn away any employer who wishes to use it.

7. We believe that only a longer staging period will reduce the operational risk to an acceptable level. It should also benefit employers by enabling both TPR and pension providers to give employers the support they need

[2] Programme and Project Management Specialism Centres of Excellence Guidance

to adjust to the reforms, and apply lessons learned to the later stages of implementation.

8. We acknowledge that this is an area in which stakeholders will have a high level of interest, but we believe that this decision should be fundamentally one which is operationally driven. However, in developing this policy, we have been mindful of likely stakeholder concerns and taken these into account as far as possible.

9. **We also considered whether to introduce the reforms all on one day** (a 'big bang' approach). Although there are significant attractions to a 'big bang' approach, primarily in communicating a simple message to stakeholders and maximising levels of contribution from the outset, there are also risks. A 'big bang' approach would clearly attract high levels of activity at launch, with a requirement for scheme providers and delivery bodies to handle peak levels of activity and enquiries from the outset. In addition, uncertainty around the number of employers and workers that will need to be processed by PADA and TPR would pose significant risk for their systems and processes. This would be set against a background where many of the employers involved would be unused to pension administration, which is likely to generate unpredictable numbers of queries, errors in data handling and amount of effort to support them. We concluded that this approach would generate unacceptable levels of risk.

Segmenting employers

10. **We are proposing to bring employers into the duties by size, broadly starting with the largest employers and ending with the smallest employers**. Employers will be staged in on a monthly basis, including some service breaks within the overall profile. We currently anticipate that the large and medium sized employers will be staged in over the first year, with small and micro employers being brought in over the following eighteen months to two years. **The exact final detail of the design (e.g. which particular sizes of employers will be brought into the duties at particular times) will be contained in the final version of the regulations laid in Parliament next year, but an illustrative example of the potential approach is included in the regulations.** We believe this is the right approach, as larger employers are the most likely to already provide a pension to their workers and therefore will need to undertake less preparation to understand and comply with the duties. This approach will also give smaller employers more time to smooth the costs of set-up. Research[3] shows that small and micro employers (those with fewer than 50 workers) are the least likely to operate a pension scheme for their workforce and therefore may need more support from their advisers and TPR to help them meet the requirements. The exact detail of the design is currently under review, and we are working to identify the optimal profile to smooth volumes and ensure deliverability.

[3] Employers' Pension Provision Survey 2007 (a report of research carried out by the National Institute of Research on behalf of the DWP.)

11. However, we also need to ensure the support, compliance regime and communications campaign work for smaller employers. To ensure that we understand the responses of this group and can adapt our approach accordingly, **we are proposing to bring a small group of randomly selected employers with fewer than 50 workers into the duties earlier** than the vast majority of small employers. It is our intention that they will be described by their PAYE reference numbers, and will be set out in the Schedule to the Implementation Regulations when they are laid in Parliament. The exact detail of the profile is under review, but we are aiming to minimise the time lag between the test group and later tranches to ensure that the employers in the test group still benefit from a longer lead-in to their duties, whilst still allowing sufficient time to evaluate the test group and implement the lessons learned.

12. Employer size will be ascertained using Pay-As-You-Earn (PAYE) data from Her Majesty's Revenue and Customs (HMRC). PAYE scheme size will be determined according to the number of employments attributed to a PAYE scheme. We recognise that a number of employers may run more than one PAYE scheme. In these cases, employers will need to meet the requirements for all their workers at the point at which their first PAYE scheme is brought under the duties.

13. The proposed staging applies to all employers who are operating PAYE for workers prior to October 2012. New employers who start to trade (and who are paying PAYE income to workers) on or after the data cut-off date will comprise the last four groups to start automatic enrolment. Employers who start trading after staging ends will need to start meeting the requirements from the date they have a worker who qualifies for automatic enrolment.

14. We believe that the proposed approach of staging employers from large to small over 36 months provides the right balance between minimising operational risks to delivery, reducing employer burden and maximising individuals' saving. We considered a number of alternative approaches to the staging length, and to the employer segmentation strategy, none of which proved to be viable options. The table below sets out the approaches considered, with the key reasons for rejecting each. A more detailed analysis of the benefits and disadvantages of each approach is set out in the appendix to the Impact Assessment accompanying this consultation.

Implementation Approach	**Key reasons for rejection**
All employers brought into the duties on day one	▪ Not operationally viable: Unmanageable peaks of activity for TPR, PADA (and pension providers) in processing employers presents a significant and untenable risk to delivery
Staged implementation using common	▪ Not operationally viable within a reasonable timescale: Using CCDs over e.g. 3 years presents unmanageable peaks of activity for TPR and PADA

commencement dates	▪ Staging manageable number of employers at each CCD would mean implementation over 14 years. This presents an unacceptable impact on individuals' saving, with some workers not enrolled until 2025
Staging employers by random selection/ 'proportional staging' (random selection within size bands across tranches)	▪ Operationally challenging, since PADA would be unable to predict their volumes to plan and build systems capacity. Would be unable to manage variable numbers of workers working for randomly selected employers ▪ Undermines effectiveness of compliance regime: TPR unable to ramp up activity from most experienced to least experienced employers, and learn from this process ▪ Significant challenge for communications; difficult for employers to understand when they will become subject to the duties and very difficult to explain to workers when they are likely to be affected ▪ Fairness and competition issues: this increases the maximum possible time between similar employers being staged in to three years
Staging employers by geographical location	▪ Operationally challenging, since employers are not evenly distributed by location ▪ The locations we would need to use to ensure operational deliverability are likely to be smaller than easily defined 'regions', creating communications challenges ▪ Fairness and competition issues, as smaller firms could be staged in prior to their larger competitors ▪ Potential equality impact issues in areas overrepresented by certain groups, compared with the UK average
Staging employers by industry	▪ Operationally challenging, since employers are not evenly distributed by industry. Also, difficult to define industry for some employers whose work covers multiple sectors ▪ Fairness and competition issues, as smaller firms could be staged in prior to their larger competitors
Staging employers by size, small to large	▪ Disproportionate burden on small and micro employers, who would contribute for longer than large employers, creating fairness and competition issues ▪ Significant operational challenge for TPR: Small and micro employers are likely to need most support, but are least predictable in their behaviour, and are most numerous employers. TPR have no time to test their systems or ramp up activity gradually

Ensuring employers know when and how to comply

15. Employers have a crucial part to play in the success of the reforms and we recognise the importance of giving all employers clear messages about how they can comply. We are working with TPR on plans to clearly communicate with employers about the forthcoming duty.

16. As part of their role in maximising compliance with the employer duties, TPR will be responsible for ensuring that employers are fully informed about their duties. TPR will write individually to all employers about 12 months and 3 months in advance of their staging date to inform them when they need to take action and what they need to do to comply.

Early automatic enrolment

17. Employers will not be able to start automatic enrolment until they are legally subject to an obligation to do so. We recognise that some employers may wish to bring forward their automatic enrolment date, perhaps to avoid busy times for their businesses. We will enable them to do so - providing employers with flexibility to plan their employer duties, and bring more people into pension saving early.

18. **We are proposing that employers will be able to bring forward their automatic enrolment date to a specified date after October 2012, preceding the date on which they otherwise would have become subject to the duties.** This is conditional on informing TPR of their intention to bring forward their duty date and being able to demonstrate that they either already have a scheme in place or are sufficiently advanced in setting up a scheme in order to discharge their duty. This will help ensure that employers who want to start automatic enrolment early allow sufficient time to make their pension arrangements.

19. We propose ensuring that allowing employers to bring forward their duty date does not cause operational problems for the PA scheme by amending the personal accounts scheme order to give the trustees discretion over whether to accept an employer before their staging date. This will allow the scheme to manage the volume risk whilst still allowing the trustees to accept employers to use the scheme where capacity allows.

20. Employers operating more than one PAYE scheme who choose to bring forward their duty date will be required to do so for all of their PAYE schemes. As in ordinary staging, the employer duties fix on employers, not on their individual PAYE schemes. Thus all employers who are running more than one PAYE scheme will need to ensure they comply with their duties for all eligible jobholders at the point at which their first PAYE scheme is brought under the duties, regardless of whether they wish to bring forward their duty date or not.

Proposed transitional arrangements for defined contribution

21. We recognise that the new employer duties will increase the cost of running a business for all employers. We are planning to phase in minimum contribution requirements over time to help employers and individuals adjust to the additional costs gradually.

22. **We are proposing that employers using defined contribution schemes be required to pay contributions of:**

- **1 per cent (of the jobholder's qualifying earnings) until staging is complete.**
- **2 per cent for a further year.**
- **3 per cent thereafter.**

23. Use of a common commencement date (1 October) is in line with Government's better regulation principles. The table below sets out the minimum contributions for employers and the total contributions required during each period, using the current staging proposals.

Period	Duration	Minimum requirements
First transitional period	Years 1-3	Total contributions must total at least 2%, employers required to pay 1%*
Second transitional period	Year 4	Total contributions must total at least 5%, employers required to pay 2%*
Steady state	Year 5 onwards	Total contributions must total 8%[4], employers required to pay 3%*

* The remaining contributions making up the total will comprise the workers' contributions plus tax relief

24. We believe this approach strikes the best balance between enabling employers to adjust gradually to the costs of the reforms, and increasing pension saving as quickly as possible. Because minimum employer contributions stay at 1 per cent for the whole implementation period, all employers will begin at this level. Employers who start the duties later will have less time on 1 per cent, but would already have benefited from a period of time where they do not have to pay contributions.

25. **We also considered using the alternative common commencement date of 6 April** to define the transitional periods. Employer representatives had mixed views about whether the increase should align with the end of

[4] Split by 3 per cent from employers, 4 per cent from individuals and 1 per cent from tax relief

the financial year in April, or with the annual increase in the national minimum wage in October. However, using the October date means that phasing of contributions aligns with the staging proposals outlined above.

26. This transition is optional and employers can always choose to pay more than the minimum requirements. Similarly workers can increase the rate of contribution payments whenever they wish, but are not obliged to follow any increases made by their employer where they are above the minimum requirement.

Proposed transitional arrangements for defined benefit and all hybrid schemes

27. Transition for defined benefit and hybrid schemes has to operate differently to transition for money purchase and personal pension schemes because employers offering defined benefit and hybrid schemes cannot pay reduced contributions and phase them in gradually. This is because funding and liability for these schemes needs to be maintained at an appropriate level agreed between the trustees and the employer.

28. Since we cannot phase in contributions for defined benefit schemes, we propose to allow employers using defined benefit schemes to delay automatic enrolment until the staging period has ended, for those jobholders who continue to be entitled to become a member of the qualifying defined benefit or hybrid scheme. As this aligns with the end of the proposed staging period, a 3-year period will allow all employers using defined benefit schemes to benefit from this arrangement.

29. To ensure jobholders working for these employers can still access pension saving, **jobholders will be able to opt in to a qualifying scheme at any point during the transitional period**. Where the employer takes on new workers after their staging date, they will have to enrol them immediately into any qualifying scheme.

30. And to protect individuals' pension savings where defined benefit schemes close, **an employer who closes their defined benefit scheme during the transitional period must enrol their jobholders into an alternative qualifying scheme.** Where that alternative is a defined contribution scheme, they will need to pay employer contributions back to the original automatic enrolment date, which could amount to 3 years' worth of contributions. This will ensure that transitional arrangements for all schemes are complete and the reforms are fully implemented by October 2016.

31. Please note the regulations on this issue are split between two statutory instruments, the Employers' Duties (Implementation) Regulations 2010 and the Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010.

<u>Summary of proposals</u>

We propose:

Staging implementation of the reforms

- Splitting employers into 25 - 30 groups according to their size, and requiring each group to start automatic enrolment on an assigned date over 3 years from October 2012 to October 2015
- Generally requiring large employers to start automatic enrolment before smaller employers

We are consulting on:

Transitional periods for defined contribution schemes

- A minimum employer contribution of:
  - 1 per cent (of the jobholder's qualifying earnings) from October 2012, for three years
  - 2 per cent for a further year
  - 3 per cent thereafter

Transition periods for defined benefit and hybrid schemes

- Allowing employers with defined benefit or hybrid schemes to defer automatic enrolment for up to 3 years
- Requiring employers who close the scheme before the end of the period to automatically enrol workers into an alternative scheme and back-pay missed employer contributions

Part Three – Maximising individuals' opportunities to save

Summary

This section deals with those parts of the employer duty that have not yet been consulted on previously. Pay reference periods are a tool to enable an employer to check eligibility for auto-enrolment and to test whether their pension scheme has met the qualifying criteria. This section also covers how individuals outside of the auto-enrolment duty may enter pension saving and the requirements around automatic re-enrolment for jobholders. In addition it consults on changes to the ability to postpone automatic enrolment for jobholders on contracts of 3 months duration or less.

Pay reference periods

1. Pay reference periods are the prescribed periods of time that will be used to:

    - Help employers identify whether their worker is a jobholder, and if so to calculate the contributions to which they are entitled.

    - Determine whether a pension scheme meets the quality criteria.[5]

2. To minimise burdens we will not be requiring schemes to change their rules for calculating contributions, but schemes need to meet the minimum levels set out in legislation.

Checking eligibility for automatic enrolment and calculation of contributions

3. The auto-enrolment and contribution provisions will be comparatively straightforward for jobholders with regular earnings. However, some workers have a pattern of fluctuating or commission-based earnings, and some schemes have their own definition of pensionable earnings with a higher or lower entry threshold than that set out in the Pension Act 2008.

4. Therefore, **we propose to set a pay reference period as that over which the jobholder receives his regular wage or a period of one week,** to enable employers to:

    - Trigger auto-enrolment and underpin the calculation and payment of contributions from jobholders, including agency workers.

[5] For defined contribution pensions the quality criteria includes ensuring there is a minimum 3 per cent employer contribution, with a minimum 8 per cent total contribution in any pay reference period.

- Collect contributions from and including the automatic enrolment date (which may be before active membership is actually achieved).

- Determine the start date of contributions for a jobholder saving voluntarily.

- To determine if the level of contributions in any given pay reference period meet the requirement for postponing automatic enrolment[6].

5. **We propose to set a pay reference period of 12 months** for those workers (accidental jobholders) who may, exceptionally, earn enough to gain jobholder status for isolated pay periods but will not earn over the threshold of the qualifying earnings band for the whole year. These people will not fall to be automatically enrolled.

Checking the scheme meets the appropriate standard

6. In the Act, the lower and upper limits of the qualifying earnings band are shown in annual terms but these can be converted into weekly, monthly, lunar monthly and quarterly figures which can be used to base ongoing contribution deductions.

7. We propose to set a pay reference period of 12 months to allow employers to identify if their scheme is a qualifying defined contribution scheme and allow them, at the end of the year, to assess whether pension contributions paid meet the minimum level requirements. Through this process of annual reconciliation, schemes will be able to continue to use their own definition of pensonable pay and this should ease the burden on schemes.

8. For certification we propose to match the period of the certificate - which will be 12 months or such other shorter period as chosen by the employer. More information on certification can be found in Part 6.

Voluntary saving

9. There are some individuals whom an employer does not have to automatically enrol: people aged between 16 and age 22; and those aged over state pension age but under age 75[7], or workers earning less than £5,035 per annum. Whilst these people are excluded from automatic enrolment, we want to maximise their opportunities to save for retirement if they wish to do so.

[6] An employer with a defined contribution scheme that has an 11 per cent overall contribution or a defined benefit scheme may postpone a jobholder’s auto enrolment date for 3 months

[7] State pension age is currently 60 for women and 65 for me. This will equalised to 65 for all by 2020 and will increase from 65 to 68 between 2024 and 2046. By the age of 75 an individual in a scheme must have secured an income for retirement, either through buying an annuity or an Alternatively Secured Pension (ASP).

People aged over 16 and under age 22 or, over state pension age but under age 75

10. Where a jobholder is outside the automatic enrolment age bands, the Act says that the jobholder can opt in to a qualifying automatic enrolment scheme and is eligible for an employer contribution.

11. **We propose that employers be required to tell these jobholders in writing** about the right to join an automatic enrolment scheme, the process for opting in, what it means for them, and where to get more information about pension saving.

12. Where these jobholders instruct their employer in writing that they want to join the scheme, **we propose that employers treat them as jobholders eligible for automatic enrolment and follow the normal automatic enrolment process** set out in the Government response to the consultation of the draft Pensions (Automatic Enrolment) Regulations.

Workers earning under £5,035 per annum

13. Workers (individuals earning less than £5,035 per annum) also have the right to join a tax registered pension scheme, but do not have the right to an employer contribution.

14. **We propose that employers be required to tell these workers in writing** that they have the right to join a pension scheme.

15. **Where a worker instructs the employer in writing that they wish to start saving in a pension, we propose that the employer must make arrangements for them to become an active member of a tax registered scheme**, which may or may not be the same automatic enrolment scheme being used for jobholders. The joining process involved will be done in accordance with the rules of that scheme.

16. To keep administrative burdens to a minimum, employers will not have to identify and set up a scheme prepared to accept workers without qualifying earnings until they receive a request from one of them to join a scheme.

Options considered

17. We **also considered alternative ways of** allowing individuals to give notice that they want to join a scheme:

    - **Simply by telling their employer**. However, stakeholder views suggested that employers and workers would want an audit trail to support wage deductions and we concluded that oral notice was not suitable.

- **By using an 'opt-in form' provided by the employer.** However, requiring employers to create or maintain such a form would create disproportionate burdens. Many employers will use third parties to handle pension processes on their behalf, and placing the requirement on the employer would prevent these third parties from providing this on the employer's behalf.

- **Sourcing a form from the pension scheme** would enforce a separation between the employer and voluntary savers but would in practice still place a burden on employers, as they would have to put jobholders in touch with the relevant scheme.

Automatic re-enrolment

18. The Pensions Act 2008[8] places a duty on employers periodically to re-enrol jobholders who have left pension saving either during or after the opt out period. While pension saving may not have been the right choice at the point the jobholder stopped saving, going forward a jobholder's earnings may have increased, financial commitments may have reduced or their priorities may simply be different. With re-enrolment we aim to maximise savings, harness decision-making inertia and take advantage of those changes.

19. The process for automatic **re-enrolment** will largely be the same as the process for automatic **enrolment.** The employer must make arrangements with a scheme to achieve active membership and issue enrolment information to the jobholder. These standard arrangements are the same for all pension schemes.

20. Where a jobholder is going back into a **personal pension scheme** of which they have been an active member in the past, the scheme is not required to re-issue the terms and conditions of the contract to the jobholder. This avoids the formation of a second contract for the same scheme.

21. Where a jobholder falls outside the definition of a jobholder for a period of time, for example because of fluctuating earnings, the employer must make arrangements with a scheme to achieve active membership from the date that jobholder status return but is not required to re-issue the enrolment information. **The regulations setting out the process for automatic enrolment are included within Annex B for ease of reference and context but are not part of this consultation process**.

22. After consultation in the May 2006[9] and December 2006[10] White Papers, in which we sought views on the frequency of automatic re-enrolment, **we now propose to regulate that jobholders should be automatically re-**

[8] The duty and timing of the duty is set out within sections 5 (Automatic re-enrolment) and 6 (Timing of automatic re-enrolment).
[9] Security in retirement: towards a new pensions system.
[10] Personal Accounts – a new way to save

enrolled every 3 years if they continue to work for the same employer[11]. To minimise employer burdens we propose to link re-enrolment to an employer anniversary, so that employers would only have to carry out re-enrolment for their workforce once every 3 years.[12]

23. **We also considered linking re-enrolment directly to a jobholder anniversary**, such as the date that the jobholder opts out. This would give individuals certainty, but would require employers to monitor each individual jobholder and carry out re-enrolment, in many cases, on a daily basis.

Date of auto re-enrolment

24. **We are proposing that employers would be required to carry out automatic re-enrolment every 3 years from their staging date**.[13] This means that pension scheme providers, TPR and employer advisory bodies will have manageable volumes of activity at any one time.

25. We also considered:

- **A single date in the year for all employers to auto re-enrol**. But we estimate that there will be too many jobholders eligible for automatic re-enrolment to make this approach viable. The volume of people being re-enrolled and enrolled, and the number of employers carrying out automatic re-enrolment, would place an unmanageable burden on both pension schemes and TPR, in terms of both responding to queries and processing enrolments.

- **Using 6 common commencement dates** (April and October over a 3 year period) **or quarterly dates over 3 years**. However, we believe these options would still carry too high an operational and compliance risk. Grouping several months' worth of small and micro employers together in a single common commencement date would create a spike in activity that would be too large to be operationally viable.

Jobholders exempt from automatic re-enrolment

26. If someone has just made a decision to opt out of pension saving we do not want their employer to have to put them back in straight away. We think it is reasonable to assume that jobholders who have recently opted out (or ceased saving after opt out) are more likely to opt out again and also are unlikely to have had a significant change of circumstances.

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[11] Anybody changing jobs during those 3 years and moving to a new employer would be auto-enrolled into a pension scheme by their new employer.
[12] Jobholders with multiple employment will be subject to this requirement for each employment
[13] Employers can adjust their enrolment and re-enrolment date by using the early automatic enrolment provisions set out in Part 3, paragraphs 16 – 19 if their allocated staging date is not convenient.

27. **We propose that jobholders be exempt from automatic re-enrolment if they have left pension saving in the previous 12 months**. We believe this strikes the right balance between allowing long enough for an individual's circumstances to change and minimising the burden on employers by not requiring them to re-enrol individuals who have relatively recently opted out of pension savings.

28. **We also considered exemption periods of 6 months and 18 months**. But we felt the former would not be long enough for an individual's circumstances to have changed significantly, and may be only a short time after the employer had completed the initial automatic enrolment process which would be administratively burdensome. And we believe the latter creates too long a savings gap and tips the balance too far away from our primary intention of increasing the number of people in pension savings.

Exceptional circumstances warranting early re-enrolment

29. In addition, **we are proposing two exceptional circumstances warranting immediate re-enrolment.** These circumstances, which we expect to be rare, are:

    - Where a third party (such as the scheme administrators) stops the scheme qualifying as a high quality defined contribution scheme used under postponement (where the employer contributes falls below 6 per cent);

    - Where a third party (such as the scheme administrators) stops the scheme being a qualifying scheme, or ends the jobholder's membership.

30. For those workers who lose jobholder status (earnings fall below £5,035 or they are no longer considered as working in Great Britain) but then start again, the re-enrolment date will be the day jobholder status returns. Where the jobholder remains a member of the scheme (but not an active member) the re-enrolment process will simply require that the employer makes arrangements with the scheme so that active membership status returns.

Employer duty to maintain active membership

31. In addition to auto-enrolment requirements employers must make sure that jobholders remain active members of a qualifying scheme, unless a jobholder chooses to end their membership. This is important for the jobholder as it protects their right to save by ensuring they remain in pension saving, even if their employer decides to make changes to their pension scheme.

32. This means that an employer may not:

- Stop a scheme from qualifying (such as by paying less than the 8 per cent minimum contribution for a defined contribution scheme).

- Eject a jobholder from a qualifying scheme.

- Force a jobholder to stop membership or opt out of a scheme.

without taking action to put the jobholder into another qualifying pension scheme. Where an employer changes their scheme they must make arrangements for their jobholders to voluntarily join the scheme and existing voluntary processes should apply.

33. Whilst an employer who is changing their pension scheme should start arranging a replacement before disrupting current pension arrangements, **we propose allowing a one-month gap** between membership of the old and new schemes to give employers some leeway to finalise those arrangements.

34. We believe this approach strikes the right balance between reassurance and fairness for employers, and minimising negative impacts on pension saving. It would keep the gap in scheme membership short, and reinforce the need for employers to be proactive and set up a replacement scheme in advance. And it mirrors the proposed one-month joining period set out in the Government response published alongside this consultation.

35. **We also considered not regulating,** so that employers would need to install a new scheme immediately and jobholders' membership would be continuous. While this could work for large employers who may be able to deal with administrative arrangements in time, it would be more difficult for smaller employers who may need more time to complete the switchover. And it would offer no certainty against accidental breach as a result of delays or events beyond the employer's control.

Amendments to the postponement of automatic enrolment regulations

36. The Act allows employers to postpone automatic enrolment for a period of time where they offer high quality schemes. This provision is intended to encourage employers offering higher-quality schemes to continue to do so.

37. This measure was contained in regulation 17 of the draft Pensions (Automatic Enrolment) Regulations which we consulted on earlier this year. This regulation allows employers to postpone automatic enrolment of an individual jobholder into a high-quality qualifying scheme for a period of 3 months after which they must auto-enrol them into that high-quality scheme.

38. The regulation, as drafted, also enables employers to use postponement for jobholders on short-term contracts. This has implications for those jobholders because employers may never enrol those with contracts of less than 3 months. This issue is a finely balanced one and we were interested to hear responses on this to assess the right balance between ensuring individuals are saving in a pension and reducing the burden on business.

39. Agency workers are explicitly within the scope of the Act. Jobholders on a fixed, short-term contract are also likely to be within our target group. We are concerned that enabling employers to use postponement to avoid enrolling jobholders on contracts of 3 months or less could prevent a group of jobholders from ever saving in a pension. **We therefore propose to change the regulations to prevent employers from using postponement for jobholders on short term contracts**. This would ensure that all jobholders on short term contracts are able to benefit from pension saving.

<u>Summary of proposals</u>

We are consulting on the following proposals:

Pay reference periods

- Requiring contributions to be calculated on the basis of jobholders' normal pay cycle
- Using a pay reference period of 12 months to check that a defined contribution scheme qualifies and to allow employers to use annual reconciliation
- For employers using certification, adopting a pay reference period of 12 months or shorter period if chosen by the employer

Voluntary saving

- Arrangements for individuals not eligible for automatic enrolment to give their employer written notice that they want to join pension saving
- A requirement on employers to provide information to these individuals about how they can access workplace pension saving

Automatic re-enrolment

- Automatic re-enrolment every 3 years, on the anniversary of the employer's staging date, for jobholders who have left pension saving and remain eligible for automatic enrolment

- An exemption from automatic re-enrolment where a jobholder has left their employer's pension scheme in the previous 12 months

Employer duty to maintain active membership

- For employers who are moving jobholders between pension schemes, a maximum break in membership of 1 month to allow any administration arrangements with the replacement scheme to be finalised

Amendments following the first automatic enrolment regulation consultation

- Changes to prevent employers from using postponement of automatic enrolment for jobholders on fixed short term contract of 3 months or less

Part Four – Maximising existing good provision

Summary

This section deals with the scheme quality tests. It outlines a certification process which allows schemes to continue using their existing pensionable pay and contribution structures, yet certify that they meet the overall quality requirements. It also covers the quality tests that will need to be met for defined benefit, hybrid and non-UK schemes.

Quality requirements for qualifying schemes

1. As previously set out, employers will be required to automatically enrol all eligible jobholders into a qualifying workplace pension scheme from the date that the duty goes live for them. At the highest level, these schemes must be tax recognised, approved or registered or meet other requirements set out in the Act or in regulations, comply with requirements for automatic enrolment and meet other minimum quality requirements in accordance with scheme type. Employers can use a wide range of scheme types to fulfil their duties but these must all meet certain qualifying criteria.

2. The high-level regulatory framework for qualifying schemes is set out in the Pensions Act. The regulations and rules include the detailed scheme requirements for different types of scheme types and is accompanied by two guidance notes included in **Annex G**.

Policy background/rationale

3. We believe it is necessary to set out qualifying standards to enable employers to be confident that they are fully compliant if their schemes meet these standards and to ensure that jobholders are on course to receive the necessary standards. We recognise that many employers already provide good quality workplace pension arrangements and we want to ensure that employers can continue to use their existing schemes where these meet minimum standards. We are also keen to help employers assess whether their schemes meet the minimum standards in a straightforward way.

4. We believe that the quality requirements set out in the Act and draft regulations and rules strike an appropriate balance between safeguarding individuals' interests and ensuring that pensions remain affordable and relatively straightforward for employers.

5. The basic requirement is that qualifying schemes should provide for an income in retirement and be appropriately regulated. The specific quality requirements for each scheme type are based on a relatively simple test of overall scheme quality. Employers will be able to self-certify in

straightforward cases but may need to pass more complex cases, such as some hybrid and defined benefit schemes, to a scheme professional for certification. We have provided guidance on this alongside the regulations and rules.

UK schemes

6. UK schemes are those with their main administration in the UK and can be defined contribution schemes (occupational or personal pension money purchase schemes), defined benefit schemes or hybrid schemes.

Defined contribution schemes

7. In order to qualify, both occupational and personal defined contribution schemes must require the equivalent of 8 per cent contributions on qualifying earnings, of which 3 per cent must come from the employer. Qualifying earnings are made up of all pay components on a band of earnings between £5,035 and £33,540 (in 06/07 terms)[14].

8. During the passage of the Bill, some employers expressed concern that the definition of qualifying earnings might require employers to make expensive changes to scheme rules and may encourage employers to lower levels of pension contribution. DWP worked closely with a number of industry and employer representatives to consider possible options for simplifying the quality requirements for money purchase schemes.

9. Following detailed discussions a number of amendments were made to the Bill to clarify and simplify the quality requirements for defined contribution schemes. First, the amendments creating sufficient scope to allow employers to calculate their pension contributions using an annual pay reference period to smooth fluctuations in earnings and making it clear that it is value of the contribution that determines whether a scheme qualifies rather than the way in which it is calculated (the reconciliation process).

10. Second, the amendments enabled the certification process. This was the last of these amendments and was introduced to enable employers offering good pension provision to certify that their schemes are on track to provide the minimum contributions for all jobholders but to not have to worry about unexpected increases in qualifying earnings during the course of the year.

11. We are consulting on the regulations and guidance underpinning this certification process. Certification does not introduce a new qualifying standard for defined contribution schemes: it is simply a means for employers to comply with the existing requirements. All employers offering UK defined contribution schemes will be able to use certification.

[14] Qualifying earnings includes salary, wages, commission, bonuses and overtime, statutory sick pay, statutory maternity pay, ordinary statutory paternity pay or additional statutory paternity pay and statutory adoption pay.

12. Certification allows employers with good schemes to continue to calculate pension contributions on basic pay and certify that they are on track to meet the quality requirements over the course of the certificate. Employers will need to review the certificate at the end of its term to make sure the scheme did meet the quality requirements. Where unexpected increases in pay during the year mean that some jobholders occasionally receive contributions below the statutory minimum, **employers will not be required to make retrospective payments, provided that the shortfall does not exceed 5 per cent of their expected contributions under the Act and that no more than 10 per cent of the jobholders in the scheme suffer a shortfall. We have also regulated to ensure that no jobholder suffers a shortfall more than once in 2 years.**

13. We have worked closely on the detail of the certification framework with a range of stakeholders and the draft regulations and guidance note setting this out is at Annex G. We now want to ensure the processes work for schemes and reduce the need for costly administrative checking.

Defined benefit schemes

14. In order to qualify, a defined benefit scheme must either have a contracting out certificate in force which is taken as evidence that the scheme meets the reference scheme test[15] or must satisfy the test in the Act referred to as the 'test scheme standard'. This test requires schemes to provide for a member to be entitled to a pension commencing at the appropriate age (currently 65) and continuing for life. The annual rate of the pension at that age must be –

    a) 1/120th of average qualifying earnings in the last 3 tax years preceding the end of pensionable service, multiplied by
    b) the number of years of pensionable service, up to a maximum of 40.

15. We would like employers to be able to determine for themselves whether their scheme qualifies wherever possible. We would welcome views on whether the draft regulations achieve the right balance between making the process straightforward for employers and ensuring individuals receive the retirement income they are entitled to.

Hybrid schemes

16. In order to qualify, **hybrid schemes will in some cases need to meet the quality requirements for money purchase schemes or defined benefits scheme and in other cases a combination or modified version of these**. The rules set out in Part 7 direct employers to appropriate requirements for different types of hybrid schemes. There are a range of hybrid schemes and we would welcome views on whether there are additional types that we have not identified and whether the proposed

[15] A test of overall scheme quality for schemes with members in employment contracted out of the State Second Pension Scheme (commonly known as contracted-out schemes)

quality requirements are appropriate and workable. The rules are accompanied by a guidance note in Annex G, which we would also welcome your views on.

Non-UK schemes

17. We are aware that some employers may wish to use schemes established outside of the UK as their qualifying scheme, for example multinational employers.

18. To enable this to happen we want as broad a range of schemes as possible to qualify. This should minimise burdens on employers by allowing them to continue to use their existing provision where possible. Also allowing individuals already in a non-UK scheme to continue with their existing provision, prevents them building up small pots which may become stranded if they then return to their home country.

19. However, we also need to ensure that savers are enrolled into secure workplace pension arrangements, supported by a robust regulatory regime. Given the different regulatory structure to that in the UK we did consider excluding non-UK schemes from either qualifying or being used for automatic enrolment. But, this was problematic, as it would go against the policy objective of enabling employers and individuals to continue using their existing pension provision where possible.

20. Therefore, **we are consulting on the basis that all non-UK schemes which meet the quality requirements applicable to UK schemes can be qualifying and used for automatic enrolment, but we are setting additional criteria for non-UK schemes in order to bring them into line with what would be expected of UK schemes**. These are:

    - The scheme must provide an income for retirement; and
    - The scheme must be regulated by a regulatory body.

21. We did also consider requiring a scheme to be tax recognised in its country of origin. However, whilst this would entitle a member to tax relief as appropriate on earnings in their country of origin, it would not entitle them to tax relief on UK earnings. For individuals whose non-UK scheme entitles them to UK tax relief, either through registration under the Finance Act 2004, Migrant Member Relief, Double Taxation Relief or Transitional Corresponding Relief arrangements this would not be a problem, but some jobholders may be a member of a qualifying non-UK scheme which is not eligible for UK tax relief. In these cases, to ensure individuals to still receive the full 8 per cent of contributions on qualifying earnings, the regulations propose that employers are required to make up the ‘missing’ tax relief where they chose to use a non-UK scheme that is not eligible for UK tax relief. We have included a couple of consultation questions around this area to elicit views on whether stakeholders view this as an acceptable solution.

22. In addition, we, and TPR, have concerns over how to minimise the risks to individuals who could be automatically enrolled into non-UK, and specifically non-European Economic Area (EEA) schemes and EEA schemes to which no directives or treaties apply that facilitate TPR's ability to protect members' benefits (generally non-EU schemes). So whilst the consultation is based on a presumption that these schemes will be allowed to be used for automatic enrolment, given the risks involved and the need to act quickly if we do conclude there is an unacceptable risk, DWP will amend the regulations to exclude these non-EEA schemes if the evidence suggests that an unacceptable risk is emerging. Therefore we would welcome views on whether we have in fact struck the right balance in allowing these schemes to be used for automatic enrolment from the outset or not, or whether there are any other steps we could take to mitigate the risk to jobholders.

23. Before the introduction of the duty we will also be issuing guidance on the use of non-UK schemes for automatic enrolment and when it will, or will not, be appropriate for an employer to use these schemes. For example, we would not expect a UK based employer with a predominantly UK domiciled workforce to be using a non-UK scheme for automatic enrolment. We would be interested in views about the appropriate scope of this guidance.

24. Although TPR will be the regulator for the use of workplace pension schemes under the Pensions Act 2008, it will not be the regulator of non-UK schemes used to fulfil the employer duty. We would be interested in your views on if and how this should be communicated to individuals.

Summary of proposals

We are consulting on the following proposals:

Defined contribution certification

- A flexible certification process to allow employers to certify that their money purchase scheme is on track to meet the minimum 8 per cent contribution requirement

Quality requirements for defined benefit and Hybrid schemes

- Allowing sponsors of defined benefit schemes to self-certify that their scheme meets the quality requirements (set out in a combination of regulations and accompanying guidance) and the detailed application of quality requirements in the form of the test scheme standard in certain scenarios
- Asking for views on whether we have identified the full range of existing hybrid schemes and whether our proposed quality requirements will work for the fullest range of schemes

Quality requirements for non-UK schemes

- Allowing non-UK schemes to be used as qualifying and automatic enrolment schemes where they provide an income in retirement and are regulated. We are also ensuring that jobholders receive their full 8 per cent of qualifying earnings, whether a non-UK scheme is eligible for UK tax relief or not

Part Five – Employer Compliance

Summary

This section deals with the compliance regime. It sets out how employers will need to register compliance with TPR and what records will need to be kept. It explains when TPR will be able to investigate and take action if a person claims they have been induced to opt out of pension saving. Also covered is further detail on some of the tools TPR can use to help enforce the payment of contributions, including the rate of interest that may be applied, the basis for estimating outstanding amounts due, and the length of the 'prescribed period' which determines when TPR can consider requiring non-compliant employers to pay their workers' contributions as well as their own. It also sets out the penalties that TPR can use, and when TPR may review notices it has issued.

Building an effective compliance regime

1. The aim of the compliance regime is to help employers who wish to meet their obligations by educating and enabling them. However, we recognise that some employers may still fail to comply, creating an unfair economic advantage over their competitors and threatening individuals' savings.

2. TPR will operate this regime, in line with primary and secondary legislation put forward by DWP. TPR will be able to take enforcement action such as issuing notices and penalties to maximise compliance. In this document we are consulting on some of the more detailed aspects of the compliance powers set out in the Pensions Act 2008.

3. The compliance approach will aim to be:

   - **Effective:** TPR will aim to maximise employer compliance across employers of all sizes and sectors, by:

     - Checking levels of initial compliance, and following up where employers are not complying, through a registration process;
     - Undertaking risk-based investigation where appropriate; and
     - Supporting and communicating effectively with all employers, but with a specific focus on small and micro-employers, who may need more help to comply. This will enable their workers to benefit from the reforms.

   - **Efficient:** TPR will draw on data held by HM Revenue and Customs (HMRC), and where possible by pension schemes, to check compliance in a cost-effective way. This approach will aim to minimise employer burden, and reflect good regulatory practice;

- **Graduated:** TPR will focus first on educating and enabling employers to comply. It is only if the employer ignores TPR's attempts at contact, or fails to take action to comply following contact, that TPR will move to enforcement. A series of escalating enforcement steps will be available to address non-compliance, including:

    - Telling employers, formally (through a notice) or informally how to put things right;

    - Imposing a penalty if things are not put right. Except where non-compliance is repeated or cannot be fixed, TPR will not be able to charge a penalty without first issuing a notice explaining how to comply; and

    - Taking effective action against the most serious or persistent non-compliance, using escalating penalties or criminal prosecution where appropriate.

- **Proportionate:** In line with principles of good regulation, TPR will respond appropriately to the nature of non-compliance and its impact:

    - By making early contact with employers who do not seem to be complying, TPR will aim to identify inadvertent non-compliance;

    - Where failure to comply is more serious or persistent, TPR will be able to take enforcement action; and

    - Where a financial penalty is imposed, there will be a right of appeal.

- **Risk-based:** TPR will weigh up the costs and benefits before taking compliance action, including the broader benefits to both employers and workers of making sure the compliance regime works well. TPR will use the information obtained through registration to inform its regulatory approach. Where appropriate, lessons from other compliance regimes such as tax, national insurance, and minimum wage enforcement will also be taken into account along with TPR's existing regulatory activity.

- **Simple:** TPR will enforce compliance in a way that is practically feasible, and can be understood by employers. TPR will issue guidance to employers explaining what they need to do.

4. TPR's approach will be risk-based and flexible. But equally, we want to assure those who comply that there will be effective enforcement for those who do not.

Information needed to check compliance

Registration

5. Employers will be required to provide information about how they have met their automatic enrolment duties, via a process of registration. TPR will check the information that it receives from employers at registration against HMRC data on PAYE schemes, and with employers' chosen pension schemes where possible.

6. Registration is needed because there are no existing sources that will allow employer data to be linked to pension data in a timely and reliable manner. It is a large-scale and efficient way for TPR to obtain a small amount of important information about all employers. Registration will enable TPR to establish, from the outset, a culture of compliance and a level playing field amongst employers.

7. **We are proposing that the information required from employers at registration include the following:**

    - Information that enables TPR to identify and contact them.

    - Information about the action they have taken to enrol their jobholders into pension saving, and where those jobholders have opted out.

    - 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.

    - 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.

8. The key consideration in developing this policy was to enable TPR to protect individuals by obtaining sufficient information to identify and follow up non-compliance in a systematic way, while at the same time avoiding over-burdening employers. We consider that this proposal represents the optimal balance between these two requirements.

9. During implementation, **we are proposing that employers will be required to register within 9 weeks after their staging date**. This will enable employers who have undertaken automatic enrolment to provide information about jobholders who have left the pension scheme during the one-month opt-out period. Where employers are able to delay automatic

enrolment for a specified period[16], they will have the same registration deadline as if they had undertaken auto-enrolment at the same time as others in their group, and will provide information about the pension arrangements they have in place that enable them to delay auto-enrolment.

10. Once staging is complete in 2015, we are proposing that new employers be required to register 3 months after PAYE income is payable on behalf of their first worker. On setting up a new PAYE scheme with HMRC, new employers will receive outline information about their auto-enrolment and registration duties, and contact details for TPR.

11. **We are also proposing that all employers be required to register every 3 years ('re-registration').** This will ensure that TPR has an up-to-date set of employer information and can therefore continue to operate an effective compliance regime. Re-registration will involve confirming contact details and pension scheme arrangements, as well as providing information about the re-enrolment arrangements that have been made and the number of workers who were already scheme members. We expect that for most employers, re-registration will follow automatic re-enrolment.

12. **We also considered**:

- **Requiring registration before auto-enrolment.** This would have involved requiring employers to register how they intended to meet their auto-enrolment duties. However, setting the registration deadline after auto-enrolment (for most employers) will yield better compliance information and enable TPR to take more targeted follow-up action.

- **A 2-step registration process,** which would have involved requiring employers to register both before and after auto-enrolment. This approach was seen as a way of both engaging employers before auto-enrolment, and identifying non-compliance after enrolment should have occurred. However, we determined that this process would be overly complex, and that early engagement should be achieved through communications to employers rather than by placing additional requirements on them.

- **Obtaining information from pension schemes,** as a means to reduce the requirements on employers. However, we believe this is unlikely to be effective for compliance purposes, because pension schemes will not hold all the relevant information on how employers have complied.

[16] 3 months for certain schemes and jobholders under s.4, or between October 2012 and October 2015 for defined benefits and hybrid schemes under s.30.

Record-keeping

13. In addition employers, trustees and managers of pension schemes and pension providers will be required to keep certain records to enable TPR to check employer compliance at a more detailed level. **We are proposing that:**

   - **Employers** be required to keep records relating to the pension arrangements they have made, the enrolment of jobholders and the opt-out and 'opt-in' processes, and the pension contributions they have made. TPR will use these records where needed to check that employers have undertaken enrolment and opt-out correctly.

   - **Occupational pension schemes and pension providers** be required to keep records of enrolments and opt-outs in respect of each employer, as well as information relating to individual scheme members. 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.

14. TPR may require these records to be produced on request[17]. In line with its principles TPR will adopt a risk-based approach in checking employer records, and will use records supplied by pension schemes more systematically to verify automatic enrolment. TPR will be discussing the requirement to verify information in more detail with private pension providers to determine the most appropriate approach.

15. **We are proposing that employers and pension schemes be required to keep most of these records for a period of 6 years,** which is the maximum time allowable under the Pensions Act 2008. This is broadly in line with other document retention legislation relating to pensions, and certain requirements for retention of tax records. This requirement does not affect the legal position on keeping and disposal of records where a company has gone into liquidation[18].

16. We believe these requirements achieve a balance of enabling TPR to check compliance effectively whilst adding to existing requirements as little as possible. Where the required information is already kept for another purpose, such as payroll or tax, duplicate records will not need to be kept to satisfy these requirements. And, to minimise costs for those using paper-based systems, we will not require records to be kept in electronic format.

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[17] Section 60 of the Pensions Act 2008

[18] Where a company has gone into liquidation, (i) the liquidator in a winding-up by a court (or in other circumstances) may at any time sell, destroy or otherwise dispose of the books, papers, or other records of the company, or (ii) where there is a voluntary winding-up, the last liquidator may at any time after one year from the date of dissolution, destroy or otherwise dispose of the company's books, papers or other records.

17. **We also considered whether it would be possible to use guidance, instead of regulations,** to set out these record-keeping requirements. However, using guidance would mean it would not be possible to legally enforce the keeping of any record. Failure to keep records could jeopardise TPR's ability to check compliance, which would be unfair on workers and compliant employers. Furthermore, this approach is not possible under the provisions of the Act.

Time limits on inducements compliance action

18. The Pensions Act 2008[19] (PA 2008) prohibits employers from attempting to induce individuals to leave a pension scheme[20]. To provide certainty for employers, their workers and TPR we intend to prescribe two time limits for enforcement action in relation to inducements[21].

The time within which a complaint can be made to TPR

19. **We propose that individuals have up to 6 months after an alleged inducement to make a complaint to TPR.** We believe this strikes the right balance between protecting employers from malicious complaints on one hand, and on the other hand giving individuals or their representatives enough time to prepare and make a complaint. Given that people will take time to grasp employers' new obligations to provide pensions, we believe it may take time for people to identify and take advice on whether a breach may have occurred.

20. **We also considered a 3-month time limit**. Employment tribunals normally give 3 months to bring a case. However, this generally applies to breaches of the law such as unlawful dismissal which are clearer cut and which cannot be initially overlooked by the individual. Furthermore, the possibility of compensatory awards and early settlements in tribunal cases means that time limits need to be tight to protect employers from malicious complaints. In contrast, the financial incentives for reporting inducement to TPR are much lower.

The time limit applying to proactive investigations by TPR

21. This determines how far back TPR can look from the point where the employer is informed an investigation is being carried out. Action (amounting to TPR having the power to issue a compliance notice) can be taken regarding inducements that occurred within the time limit.

22. **We are proposing 12 months** from the date of the inducement as the minimum period TPR would need in order to consider taking compliance

[19] See section 54 of the Pensions Act 2008.
[20] We are also proposing to make a minor Order (the Public Interest Disclosure (Prescribed Persons) (Amendment) Order 2009) to ensure the intent of Chapter 3 (Safeguards: Employment and Pre-employment) of the Pensions Act 2008 is fully expressed in law. The Order ensures that workers who report inducement or prohibited recruitment conduct are fully protected by rights not to suffer unfair dismissal or detriment.
[21] Under the enabling power in s54(3(a) and (b).

action in the context of its own proactive investigations. Nevertheless, 12 months is significantly shorter than the length of time an induced opt-out may remain effective, i.e. before the individual is automatically re-enrolled which may take up to 4 years. We would welcome views on whether 12 months is long enough.

Ensuring payment of all contributions due

23. TPR already has powers to take action where pension schemes report that contributions have been paid late. The new duties will mean that from 2012 many more employers will have to deal with paying pension contributions themselves and deducting and paying contributions on behalf of their workers. Therefore, TPR will need to be able to deal with a potentially higher volume of late payment reports, as well as the situation where, due to a breach of an employer duty or the inducements measure, an individual has not become a scheme member and backdated contributions may be due. The Act gives TPR discretion to issue compliance notices and unpaid contributions notices to address these forms of non-compliance.

Due date[22]

24. To be able to issue an unpaid contributions notice TPR must be of the opinion that the contributions have not been paid on time. This depends on knowing exactly what that deadline was. That deadline is a scheme-specific deadline and at present not all scheme reports to TPR include this date – many just state the month. Prescribing a due date that would allow TPR to assume a particular date in the month, without having to seek detailed information from schemes, will help minimise burdens.

25. **We are proposing to set a due date for all unpaid employer and worker contributions of the 19th day of the month** following the month in which workers' contributions were deducted or when employer contributions were due.

26. This fits with existing legislation requiring that worker contributions must be paid over by the 19th of the month following their deduction[23], and with what we understand to be the normal industry practice of arranging for employer contributions to be paid over at the same time. Exceptions will apply for occupational defined benefit and hybrid schemes and are set out in the regulations.

Time limit on when TPR can choose to require employers to pay worker contributions[24]

27. Where employers fail to deduct worker contributions for some time (e.g. by failing to automatically enrol on time), a large backlog of worker

[22] Section 37(3) Pensions Act 2008.
[23] If stakeholders support changes to the 19 day rule for the period during which a worker is being automatically enrolled (see Part 10), we would consider amending this regulation accordingly.
[24] Section 38(2)(b)(c).

contributions may build up. It would disadvantage the worker if they had to make up a large backlog, or accept a shortfall in their pension fund. This would be particularly unfair where the employer has been wilfully non-compliant. The Act provides TPR with discretionary powers which can be used in a compliance notice or unpaid contributions notice. One of these is the ability to require employers to pay their worker's contributions (as well as their own) where:

- contributions are overdue; or
- where employer duties or the inducements provision[25] have been breached,

and backdated contributions are required to put the worker back in the position they should have been in.

28. This requirement may be imposed only where a 'prescribed period' has expired.

Length of the prescribed period

29. The length of the prescribed period needs to achieve:

- Operational viability (thereby maximising compliance activity);
- Protection for individuals (including risk of opt-out and the bewildered employer); and
- Proportionality of the effect on employers.

30. **We are proposing a prescribed period of 3 months.** This would give employers time to sort out any 'teething' problems before they may be liable to be asked by TPR to pay both sets of contributions on their own account. For workers, a 3-month period should minimise any loss in the value of the fund, or alternatively the financial impact of making good their own missing contributions, should they choose to do so.

31. **We also considered** a shorter period of 1-2 months and a longer period of 6 months. But a shorter period could be considered unfair on employers who were just unsure how to comply rather than being wilfully non-compliant. And a longer period would create serious gaps in worker contributions that may not be able to be made good by the individuals themselves or be required of the employer.

[25] Section 54, see also 'inducement time limits', above.

Requirement to pay interest[26]

32. TPR will have discretion to apply interest when requiring payment of contributions. Any payment of interest goes into an individual's fund to help compensate the individual for any loss of investment growth.

The rate of interest

33. **We propose that interest be calculated on a simple per annum basis, using a two-part formula comprising an estimate of long-term return plus allowance for inflation**. The proposed formula is 4.9 per cent plus Retail Price Index (RPI) per cent = interest per annum. The first part is derived from a measure of long-term return on equities[27] which will approximate equity loss without needing constantly to revise the regulations. The second part helps address the potential of inflation to erode nominal returns on capital and thereby protects the real value of the interest rate.

34. **We also considered:**

- **Calculation of interest on a compound basis**. However, this would add administrative burdens on employers and risk confusion without making a substantial financial difference in the vast majority of cases.

- **Using an interest rate based on the Bank of England base rate**, plus a mark-up that can be adjusted by a Treasury Order. HMRC recently legislated[28] for such an approach using the base rate as the starting point for their calculations (the late payment rate formula is 0.5 per cent + 2.5 per cent and the repayment rate formula is 0.5 per cent – 1 per cent with an underpinning baseline of 0.5 per cent) but their legislation no longer requires a Treasury order when their rates change. We decided against using the same formula because we needed a rate with greater long-term stability, and also one tied to equity returns rather than cash interest rates in order to properly compensate individuals.

Estimating amount of unpaid contributions[29]

35. In the event a non-compliant employer fails to engage with TPR to calculate the correct amount payable, TPR needs a method of estimating the amount of unpaid contributions.

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[26] Section 38(2)(e).
[27] Obtained from Barclays Equity Gilts Study, considered the most current and reliable source available.
[28] SI 2009/2032
[29] Section 38(3) and (4)

36. We are proposing the following estimation formula[30]:

Unpaid contributions owed = maximum monthly qualifying earnings
x 8 per cent
x number of jobholders affected (or PAYE scheme size where the number of jobholders affected is unavailable)
x number of months late.

37. This will help ensure that an employer does not gain from their refusal to engage with TPR.

Penalties and reviews of compliance activity

Penalties

38. Although its approach is 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 the employer duties and safeguards.

39. A fixed penalty is intended to get the attention of employers who have failed to engage with the reforms despite the provision of information and support. The daily escalating penalty is intended to target more entrenched non-compliance and prevent such employers gaining a financial advantage over their competitors. In order to reflect the potential financial advantage, it needs to be significantly higher than the fixed penalty.

Fixed penalty notices

40. **We are proposing a flat-rate fixed penalty of £500**. We believe this is large enough to act as a serious "wake up call" to employers who have not responded to earlier warnings, but low enough not to excessively affect small businesses. And a flat-rate penalty is easy to administer and communicate to employers.

41. **We also considered:**

- **Scaling the fixed penalty by the number of jobholders involved**. But this would add complexity to the penalty system and be harder to communicate to employers.

- **An early compliance discount** along the lines used by the National Minimum Wage (NMW) regime. However, whereas compliance with NMW involves a simple payment, TPR will use fixed penalties to

[30] Expressed slightly differently in regulation 12(2) of the Registration and Compliance Regulations but amounting to the same.

address a wide range of breaches from inducement to failure to keep records to failure to auto-enrol. Furthermore, it may take some time to rectify some of these breaches and involve other parties. We have concluded that such a discount would not be operationally feasible.

- **A discount for prompt payment of the penalty.** This would pose fewer operational difficulties, but its impact on behaviour is not certain. Quick engagement with TPR may motivate non-compliant employers to become compliant more quickly. It may also be reasonable to recognise the effort such employers are making to respond promptly to the 'wake up call'. However, some may be tempted to pay quickly and continue non-compliance; the discount merely reduces the real level of the penalty.

Escalating penalty notices

42. Escalating penalties are intended to address entrenched employer behaviour and provide a meaningful deterrent to non-compliance. **We are proposing a system of escalating penalties that vary by employer size and aim to address the financial advantages of non-compliance.** The proposed penalty levels were calculated by estimating the total amounts of unpaid contributions that a non-compliant employer could owe over a 2-year period:

Size of PAYE scheme	Penalty
1 - 4 workers:	**£50** per day
5 - 49 workers:	**£500** per day
50 - 249 workers:	**£2,500** per day
250 - 499 workers:	**£5,000** per day
500+ workers:	**£10,000** per day

43. If escalating penalties are to address the financial advantages of non-compliance, they need to relate to the amount of contributions an employer could save. A major influence on the size of this potential gain is the number of jobholders involved. We therefore consider that escalating penalties should be scaled, as near as possible, according to the number of people affected by the non-compliance. In most cases this will be estimated using PAYE data. Where the penalty is in respect of a failure to comply with an unpaid contributions notice the exact number of people affected will be used where provided by a pension scheme.

Third party penalties

44. Third parties, e.g. trustees or managers of a pension scheme, payroll administrators, accountants or pension scheme administrators, could become liable to both fixed and escalating penalties. This could happen through their not complying with a third party notice if they have contributed towards an employer duty failure. In some circumstances they

may be subject directly to an employer duty themselves and could as a result be issued with a Compliance Notice.

45. **We are proposing a fixed penalty of £500 and an escalating penalty of £200 per day for third parties**. These rates reflect that third parties are providing a professional service to employers and as such should have a high standard of care.

46. **We also considered ways of scaling penalties for third parties** but none were viable. For example, not every third party would have an associated PAYE scheme and even where they do, the size of the scheme may bear no relation to the gravity or impact of their non-compliance. Nor can TPR always know the number of people affected by the third party's non-compliance.

Prohibited recruitment conduct penalties

47. 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[31]. 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.

48. Where an employer has carried out prohibited recruitment conduct, **we are proposing a system of fixed penalties that vary by employer size and are higher than other fixed penalties**. This reflects that employers who deliberately contravene this measure are in effect trying to avoid all of their duties under the reforms, and that escalating penalties cannot be applied for prohibited recruitment conduct. The proposed rates, based on PAYE scheme size, are as follows:

Size of PAYE scheme	Penalty
1 - 4 workers:	**£1,000**
5 - 49 workers:	**£1,500**
50 - 249 workers:	**£2,500**
250+ workers:	**£5,000**

49. **We also considered a flat rate penalty of £1,000** but concluded that the scaled rate option should provide a more proportionate response and a stronger deterrent. We believe it is right that larger firms who are more likely to have HR departments able to advise on correct recruitment behaviour should face higher penalties.

Review of notices

50. Recipients of statutory notices under the regimes (e.g. Compliance Notices, penalty notices, unpaid contributions notice) will be able to ask for a review of a notice by TPR, and also present new evidence. TPR will also

[31] See sections 50, 51 and 52.

be able to initiate a review of a notice if appropriate, and to change its decision as a result.

51. **We are proposing:**

- **That a person issued with a notice has up to 28 days to make an application for a review**, starting from the date the notice is issued. This is in line with current regulatory business practice.

- **Up to 18 months for TPR to initiate a review of a notice it has issued**, again starting from the date the notice is issued. As a person may request a review of a notice that is linked to notices or penalties that have been issued previously, an 18-month period will give TPR enough time to review earlier, related compliance actions.

<u>Summary of proposals</u>

We are consulting on the following proposals:

Information needed to check compliance

- Requiring employers to register compliance with TPR by 9 weeks after their staging date, and every 3 years subsequently
- Requirements on employers, pension schemes and pension providers to keep certain records for 6 years

Time limits on inducements compliance action

- A 6-month time limit in which complaints about being induced to leave pension saving can be made to TPR
- When TPR initiates an investigation without a complaint of inducement, limiting to 12 months the period over which it can look back and take action against any inducements identified

Ensuring payment of all contributions due

- Fixing a 'due date' of the 19^{th} day of the month following the month in which workers contributions were deducted or when employer contributions were due, to allow TPR to issue a notice for unpaid pension contributions without having to ask the pension scheme when contributions became overdue
- Prescribing a 3-month period after which TPR may require non-compliant employers also to pay their workers' outstanding contributions
- A rate of interest which TPR may require employers to apply to outstanding contributions which will be calculated as 4.9 per cent (an estimate of long-term equity return) plus Retail Price Index (RPI) per cent

- Where an employer refuses to calculate the amount owed, allowing TPR to estimate based on a worst-case scenario that assumes contributions are owed for all workers, on 8 per cent of the full band of qualifying earnings for each worker, for every month overdue

Penalties and reviews of compliance activity

- A £500 fixed penalty for non-compliance with employer duties or inducements, and an escalating penalty from £50 to £10,000 per day linked to employer size for persistent or serious non-compliance
- For prohibited recruitment conduct, a fixed penalty from £1,000 to £5,000 linked to employer size
- A 28-day time limit in which recipients can seek a review of a notice TPR has issued
- An 18-month time limit in which TPR can initiate a review of a notice it has issued

Part Six – Minimising refunds

Summary

This section covers changes to existing legislation which should assist in reducing the burden which refunds following opt-out could create.

Background

1. Section 49(8) of the Pensions Act 1995 states that pension contributions deducted from a worker's earnings must be paid to the trustees or managers of the scheme within a prescribed period.

2. Regulation 16 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996 states that the prescribed period is 19 days commencing from the end of the month in which the amount is deducted from the earnings in question. For example contributions deducted on 1 October would have to be passed over by 19th November.

3. There is a similar requirement for workplace personal pensions (WPPs) where direct payment arrangements exist in section 111A (15)(b) of the Pensions Schemes Act 1993 and regulation 5 of The Personal Pension Schemes (Payments by Employers) regulations 2000.

4. The *19 day rule* was introduced as part of the post-Maxwell pension reforms. It seeks to mitigate the risk that pension contributions, once deducted remain in the employer's bank account invisible to the scheme trustees or the provider and at risk of misappropriation. Within the current 19 day rule the employer can hold onto contributions for a maximum of 50 days but no longer.

Opt-out and refunds

5. Under the new employer duty, a jobholder must become an active member of a qualifying scheme with effect from day one (the automatic enrolment date). The regulations provide that contributions must be deducted on the first occasion an individual is paid after that date.

6. Where a jobholder chooses to opt out, the effect is that they were never members of the scheme and therefore any contributions paid by the jobholder must be refunded.

7. Due to the 19 day rule outlined above, there will be times when contributions are deducted by the employer and will have to be paid over to the scheme during the joining and opt out window. These contributions would have to be refunded to the jobholder via the employer if they subsequently opt out.

8. In response to the consultation on the draft Pension (Automatic Enrolment) regulations 2009, employers and schemes said that having to pay over contributions and then subsequently refund those contributions for a jobholder who opts out creates significant burden and cost.

9. A significant cross section of stakeholders said that DWP should seek to find a wider legislative fix that will make the arrangements work better. Many suggested that we legislate so that contributions would not be taken until after the opt-out period. We decided against this option, as under the Act pension accrual starts from the automatic enrolment date. Legislating for this would create a significant contribution cliff-edge for jobholders and employers, which we believe is unacceptable from a policy perspective.

Amendment to the 19-day rule

10. A way of responding to stakeholder concerns and easing the administrative burden around refunds is to look at what employers have to do with worker contributions after they are deducted from a jobholder's salary, during the joining window and opt-out period.

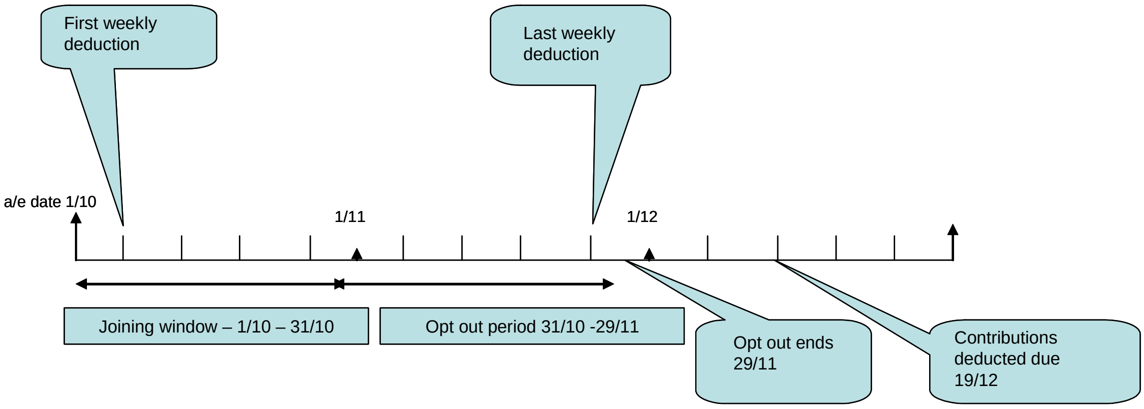
11. Amending the 19-day rule and extending the due date for worker contributions deducted during the joining window and opt-out period would allow employers to hold onto contributions until after the opt out period has passed. This would reduce the need for schemes to refund worker contributions back to employers shortly after having received it, where the jobholder opts out and removes the investment risk of worker contributions losing value where immediate vesting occurs. It would also reduce cost and administration burden for employers who would be able to refund worker contributions out of existing funds.

12. We do not propose to alter the core principle that pension contributions must be paid to the scheme to a timetable agreed with trustees or the provider. We also do not intend to extend the timescale within which worker contributions must be paid over to the scheme on an ongoing basis beyond the opt-out period. Any contributions deducted after the end of the opt-out period would be required to paid over to the scheme by the 19th day of the month following deduction as the legislation currently requires.

Extending the due date

13. We propose to extend the deadline for payment for those contributions deducted during the joining window and opt-out period to the 19th day of the second month following the month in which the jobholder's automatic enrolment date applies. This makes the due date clearly identifiable and means contributions would not need to be passed over until after the opt-out period has ended. Further, it minimises the amount of extra days the employer will hold onto contributions as it effectively extends the current timescale by one month.

Diagram illustrating contributions deducted during the joining window and opt out period due 19th day of the 2nd month following the month in which the automatic enrolment date applies (based on the maximum timescales)



14. We considered other options, including extending the due date to:

- the 19th day of the month following the end of the opt out period;
- the 19th day of the 2nd month following deduction; and
- the 19th day of the 3rd month following deduction/automatic enrolment.

15. In order to minimise any increased risk to members' benefits it is vital that any amendment to the due date for contributions deducted during the joining window and opt-out period still ensures that contributions are paid over to the scheme as soon as possible after the opt-out period ends. The amendment should be simple and easy to reflect on a payment schedule and easy to implement. The option should not create any opportunity for manipulation or non compliance. We concluded that the other options could lead to detriment to the member for one or more of the above reasons.

16. This change for employers must be balanced against the effect any extension has on the protection of members' benefits. By extending the due date for those contributions deducted during the joining window and the opt-out period we would be allowing employers to hold onto monies for a longer period of time, so it is important that we carefully consider the impact on risk to individual's contributions, i.e. would this extension significantly increase the likelihood of funds being misappropriated or being lost through corporate insolvency. We would welcome views on the level of increased risk.

17. An extension to the due date of 1 month would mean that for an average member the extra contribution held would be around £55 (mean qualifying earnings for eligible individuals currently without a workplace pension are

around £13,000, the value of total monthly contributions of 8 per cent based on these qualifying earnings is £88, the jobholder contribution including tax relief is £55).

18. It is also important to consider the administrative cost and burden of any system changes and amendments to payment schedules that would be required to implement this due date change and compare that to the likely cost/burden saving achieved in relation to refunds. We would welcome feedback on these practical arrangements and changes that would need to be made.

Summary of proposals

We are consulting on the following proposal:

- Amending regulations so that contributions do not need to be paid over until the 19th day of the 2nd month following the month in which the automatic enrolment date applies.

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