Technical Changes to Automatic Enrolment

Government response to the consultation on draft regulations

March 2015

Contents

Introduction

From October 2012 a new duty on employers was introduced requiring them to automatically enrol all workers who ordinarily work in the UK into a workplace pension scheme, subject to age and earnings conditions[1]. The roll-out of automatic enrolment is being staged, starting with the largest organisations and will be extended to all employers over the next three years.

Automatic enrolment is designed to target non-savers and under-savers. This includes those individuals whose employer provided a scheme but did not pay into it; and those where the employer provided a scheme but not one that everyone could access. It obliges every employer, irrespective of size or industry, both public and private sectors, to provide a workplace pension and pay into it.

Since the original framework was laid down in Pensions Act 2008 (PA08) and the Occupational and Personal Pensions Schemes (Automatic Enrolment) Regulations 2010 (the 2010 regulations), there have been changes to the legislation to make automatic enrolment easier to operate. The Coalition Government's review in 2010 introduced the facility of postponement, the automatic enrolment earnings trigger and gave employers more flexibility to choose their re-enrolment dates. The staging timetable has also been extended to give small and micro employers[2] until at least June 2015 to prepare for automatic enrolment. Following the early experience of live running and listening to feedback from stakeholders, further changes were introduced from November 2013. These aimed to simplify the worker assessment processes to better align with existing payroll processes. The legislation on Test Schemes was also amended to deliver greater consistency across the quality tests for various Defined Benefits (DB) schemes.

More recently, following a consultation on technical changes to automatic enrolment, run in early 2013, measures were included in the Pensions Act 2014 (PA14), which are intended to further simplify automatic enrolment and reduce burdens on employers. These measures are designed to:

- Introduce an alternative quality requirement for DB schemes
- Simplify the information requirements on employers
- Create exceptions to the employer duty in certain circumstances

From 1 December 2014 to 9 January 2015 the Department consulted on draft regulations which set out the detail of these measures. In particular we sought views on whether the draft regulations achieve the overarching policy intent of simplifying

[1] Workers aged at least 22 and under state pension age who earn more than £10,000 per year (in 2014/15).
[2] Employers with fewer than 50 workers.

the process for employers. We also wanted to ensure that those who will benefit most from pension saving continue to be automatically enrolled and that there are no unintended consequences for individual savers.

We received 49 formal written responses from employer organisations, pension providers, accountants, independent financial advisers, lawyers, actuaries, trades unions and consumer organisations. We are grateful to everyone who replied. A list of organisations that responded to the consultation is at Annex A.

Responses were broadly supportive of the aims of the regulations with most respondents agreeing that they would reduce burdens on employers. There were a few responses which also made suggestions that were outside the scope of this consultation.

Alternative Quality Requirements for Defined Benefits Schemes

Background

Employers using a Defined Benefits (DB) scheme to comply with their automatic enrolment duty must ensure the scheme meets the quality requirement. Currently a scheme can meet the quality requirement simply by virtue of being contracted out of the state second pension. Non-contracted out schemes must meet the Test Scheme Standard (TSS). A scheme meets the TSS if it provides benefits which are broadly equivalent to a hypothetical Test Scheme.

Contracting-out will end from 6 April 2016 with the introduction of the new State Pension. Employers using a contracted out DB scheme will not, therefore, be able to satisfy the quality requirements on the basis of a contracting-out certificate from that point onwards. Those employers would have to use the TSS, to ensure their scheme meets the quality requirement for automatic enrolment.

The Government canvassed views from stakeholders, as part of a public consultation in 2013, as to whether there was a more straightforward way for DB schemes to demonstrate that they were of appropriate quality for automatic enrolment. The majority of respondents felt that the existing quality test was unnecessarily complex and employers would benefit from the flexibility to use an alternative, simpler test. An alternative quality test for DB schemes was introduced in PA14, the high level framework of which is set out in section 23A of PA08.

The recent consultation focused on detailed proposals for the alternative requirement at section 23A(1)(b) of PA 2008. That section set out that a DB scheme would qualify for use under automatic enrolment if “the cost of providing the benefits accruing for, or in respect of, the relevant members over a relevant period would require contributions to be made of a total amount equal to at least a prescribed percentage of the members’ total relevant earnings over that period.”

What the consultation asked

Q1: Does the level [the prescribed percentage] of the alternative test deliver broad equivalence with the Test Scheme?

Q2. Will these variations [in the definition of relevant earnings] be helpful to employers? Are they still valuable even though they add some complexity to the test? How many employers do you think will take advantage of these variations?

Q3: Does this definition [of relevant period] meet the needs of schemes? Are there scenarios where this definition would create additional work for schemes/employers?

Is the default period of 12 months an appropriate period for schemes which may not have an actuarial valuation or control period?

Q4: Does this definition [of relevant members] fit with existing practice? Are there any circumstances in which it would cause problems or additional work?

Q5: Are there any risks in not prescribing methods and assumptions [for the calculation of the cost of providing the benefits]? Does this provide an incentive to select methods or assumptions which enable a scheme to meet the test where it otherwise might not?

Q6: Does this fit with existing practice and provide simplicity [in relation to benefits to be included/disregarded]? Are there any circumstances in which it would cause problems or additional work?

Q7: Are there any particular risks in not requiring an actuary to explicitly certify that the scheme meets the cost of benefit accruals test?

Q8: Are there schemes which: cannot use the alternative proposed; could not demonstrate appropriate quality via the shared risk route; and should be allowed to satisfy the money purchase quality requirement? If so, what are they and how could they be prescribed?

Q9: Are there circumstances in which an individual level cost of accrual test would provide a simpler way to demonstrate compliance with the DB quality requirement?

Responses to the Consultation

Of the 49 formal written responses to the consultation, just under half commented on the alternative quality test for DB schemes. We received representations from employer organisations, pension providers, accountants, independent financial advisers, lawyers, actuaries, trades unions and consumer organisations.

Most respondents confirmed that the alternative test proposed under section 23A(1)(b) was broadly equivalent to the Test Scheme Standard. They welcomed it as a simplified route for employers to ensure that their DB schemes meet the relevant quality threshold for automatic enrolment. Some also suggested that the simplification would particularly benefit employers of formerly contracted-out schemes who will be reviewing their schemes, following the abolition of contracting-out.

Some responses questioned the rationale of a different test for Defined Benefits and Defined Contribution (DC) schemes, as the alternative test is based on funds paid in rather than benefits paid out.

We received a number of detailed suggestions to make it easier for employers and their advisers to apply the test which included:

- clarifying how the test is to be applied at benefit scale level by providing a more detailed definition of “different benefit scales”;

- giving flexibility for the test to be carried out at the individual employer level in a multi-employer scheme or at the scheme level;

- using a more generic definition of actuarial reports so that the most relevant can be used to determine the cost of future service accruals easily and the period over which the cost has been estimated; and

- providing for additional definitions of relevant earnings for schemes that offset their definition of pensionable pay by the basic State Pension or the Lower Earnings Limit for National Insurance.

Some respondents also highlighted a difficulty for a small minority of schemes that are DB schemes under the definitions in PA08, yet have characteristics that are much more akin to a DC (money purchase) scheme. This presents a problem for these schemes as neither the TSS nor the new cost of accruals test offer an appropriate fit. The responses acknowledged that these schemes are likely to be re-classified as "Shared Risk Schemes" under the proposals in the Pension Schemes Bill 2015 (now the Pension Schemes Act 2015).

While this means that this issue could be addressed through the Shared Risk Scheme Rules, these are unlikely to be in place before the staging dates of employers using this type of DB scheme. For the time being, these schemes cannot use the alternative quality test proposed; could not demonstrate appropriate quality via the shared risk route which is not yet defined or in force; but could satisfy the money purchase quality requirement. Some employers would therefore need to use a different scheme to comply with their automatic enrolment duties under current law and it is unlikely that the employers in question would switch back to the original schemes in question.

Respondents suggested that in the intervening period, before the Shared Risk Scheme Rules are made, a transitional provision could be made under section 23A(1)(a) to allow these types of scheme to meet the existing test for DC (money purchase) schemes under section 20 of the PA08. A number of suggestions were put forward as to suitable conditions.

Government Response

The policy intention has been, where possible, to keep the alternative test as simple as possible and for it to run in parallel with existing requirements in relation to scheme funding so that actuarial work required for scheme funding purposes can be relied upon for this test as well. Based on the feedback from the consultation, we have made a series of changes to former regulation 32L to ensure that the policy intention is delivered. These include amending the regulations so that:

- Regulation 32M paragraphs (3) and (4) establish the definition of relevant members. In many cases this term will mean the active members of the DB

scheme. However, where there is a material difference in the cost of providing benefits for different groups of members over the relevant period (see below on the meaning of 'relevant period') the relevant members will be those active members in each group. The actuary is required to determine whether there would be a material difference in cost between benefit scales. In making that judgement, the actuary must consider the criteria under which members accrue or accrued benefits over the relevant period including those set out in paragraph (4).

- Regulation 32M paragraph (6) establishes that in the case of multi-employer schemes, there is no requirement for the test to be applied to each individual employer. However, to accommodate schemes that break down the analysis or wish to break down it by individual employers, the participating employers can choose to apply the test in respect of their workers.

- Regulation 32M paragraphs (7) and (8) establish the period over which the cost of future service accrual is to be determined. That determination can be linked to other actuarial work or funding reports which should limit burdens on business. To make this easier, we have widened the type of actuarial reports on which the relevant period can be based. The revised definition encompasses both public service schemes and private sector schemes**.** Provided that there have been no changes to the benefits, since the effective date of the last report, the relevant period can be determined by the most recent actuarial report, which provides details of the cost of accruals by reference to a period that begins later than the date of that report. This could include funding valuation reports, schedules of contributions or periodic funding updates etc. Alternatively, a 12 month period may be used. If there has been a change in benefits after the date of that report or after the 12 month period has started, employers using this test must obtain or use another report that details the cost of benefit accrual and the period over which the cost has been assessed after that change, or use a 12 month period after that change, or the Test Scheme Standard.

- Regulation 32M paragraphs (9) and (10) establish the definition of earnings to be used in the test and the corresponding percentage of those earnings. We have extended the definition of earnings to include schemes that offset the basic State Pension or the lower earnings limit from their definition of basic pay. To ensure that the alternative test remains broadly equivalent to the Test Scheme Standard, that uses the band of qualifying earnings, the required percentage based on this narrower definition of earnings has been set at 13%. The level of contributions and earnings definitions will be reviewed in 2017.

- Regulation 32M(11) states that if a scheme does not provide survivors' benefits payable on the death of the member, the percentages set out below are reduced by 1%. This is to maintain broad parity with the Test Scheme Standard, as employers using this test cannot use survivors' benefits towards meeting it.

Definition of relevant earnings Regulation 32M(7)	**Percentage of relevant earnings Regulation 32M(8)**
Qualifying earnings	10%
Basic pay (usually excludes overtime bonuses etc)	11%
Pensionable earnings that are equal or more than basic pay and for all members of the scheme their pensionable earnings at least 85% of their total pay	10%
Pensionable earnings that are equal to all the member's earnings	9%
Earnings above the basic State Pension or the lower earnings limit	13%

Other issues

Transitional easement for schemes

We were asked to enable the cost of accruals test to be satisfied on a scheme-wide average rather at benefit scale level for schemes that satisfied the Reference Scheme Test on 5 April 2016. We think that there is merit in this suggestion and plan to consider it, along with other consequential amendments and transitional savings in the run up to the abolition of contracting out.

Methods and assumptions

Respondents were generally pleased that we were not specifying the methods and assumptions that underpin the test. They did not see this flexible approach as presenting undue risk. However, we expect that actuaries will use those methods and assumptions used for other purposes – scheme funding or its equivalent in unfunded schemes.

Benefits to included/disregarded

There were mixed views with some arguing that it would be helpful to clarity whether money purchase benefits or death benefits should be excluded. Other comments suggested that it would undermine the simplicity of the test. We have decided not to include or disregard any benefits accrued under the scheme explicitly. However, there is an additional 1% cost on schemes that include survivors' pension benefits in the cost of accruals test, as these benefits are not a feature of the Test Scheme Standard.

Actuarial certification

The majority of respondents felt that employers could undertake the test but were concerned that some might make a genuine mistake due to unfamiliarity with the data. We expect that employers will use existing scheme documentation in order to

determine whether their scheme meets the quality requirement and that in practice, this will become a standard part of reports provided to the employer by the actuary.

Other alternative quality requirements

We want to minimise the burdens on employers and schemes by providing a further flexible alternative for DB schemes that meet some specific conditions under section 23A(1)(a) in order to be qualifying schemes. This is based on the money purchase quality requirements (of contributions of at least 8 per cent of qualifying earnings). The intention is to provide a transitional provision, to be revoked once the Shared Risk Scheme Rules are developed, which allows these types of schemes to meet the existing quality test for DC schemes under section 20 of the PA08.

We have considered the suggestions offered by respondents and regulation 32L sets out specific conditions that such schemes must satisfy in order to be allowed to qualify under this provision.

Individual level cost of accruals test

The overwhelming response was that such a test would not be welcome so we are not minded to legislate for such a test.

Consequential amendments

We have made a number of consequential amendments to the provisions relating to hybrid schemes and non-UK schemes to enable their sponsoring employers to use the alternative quality requirements should they wish.

Guidance and Review

We intend to update our Guidance on DB schemes to include a section relating to these alternative DB quality requirements.

Section 23A of the PA08 requires the Secretary of State to review any regulations in force under this section during 2017 and then at least every three years.

Proposed changes to the Information Requirements for Employers

Background

Section 10 of the PA08 originally required the Secretary of State to make provisions in regulations for what information he requires employers to give individuals about the

effect of the employer duty on them. Section 38 (1)(a) of the PA14 amended section 10 of PA08 to give the Secretary of State a discretion as to what may be prescribed in regulations.

The current legislation means there are 5 different pieces of information that an employer must give to different types of worker about what is happening to them under automatic enrolment. The requirements are complicated and can require more than one communication or notice to be given to the same person in quick succession. This has led to a degree of confusion for the individual and imposes an unnecessary burden on employers because they need to constantly assess their workforce and send different letters to different workers. Separately, there are also the postponement notices, which enable the employer to exercise their choice to use postponement and issue a notice to defer the automatic enrolment date. The postponement notice has 4 sub-types for the employer to choose between, which vary the requirements according to the category of worker.

These requirements present employers with a number of difficulties including identifying the different requirements relevant to each worker. An employer (or their agent/service provider) needs to understand the distinction between all these types of information; the different minimum content requirements; and the deadlines in order to comply with their information-giving duties. This adds to the complexity and compliance difficulty. The effect of the current requirements also means that an employer must continue to assess their workforce to identify the first time that section 7 (jobholder's right to opt in) or section 9 (workers entitled to join) PA08 applies to that worker.

The policy intention behind these regulations is to reduce the employer's obligation to make an on-going assessment of all categories of workers. It also aims to facilitate one individualised communication, which suits all circumstances and reduces the information requirements to a basic minimum that would be appropriate for all types of worker.

<u>What the consultation asked</u>

Q10: Does revoking regulation 17 and amending regulation 21 reduce the practical burden of information requirements for employers?

Q11: Will these amendments [in question 10] enable the employer to combine the information to employees within a single communication and remove the need to assess on a continuous basis?

Q12: Will employees receive the information that they need at the right time?

Q13: Does amending [regulation 24] reduce the practical burden of information requirements for employers?

Q14: Will employees receive the information that they need at the right time?

Q15:- Would the removal of the notice under regulation 33 reduce the practical burden of information requirements for employers?

Q16: Is it agreed that the notice under regulation 33 serves little purpose and can be removed without any risk to employees?

Q17: Would the removal of paragraphs 2 and 3 be welcome and help get away from individualised communications thereby reducing administrative costs for employers?

Q18: Are there any risks to the employee in not receiving the information in paragraph 2?

Q19: Is there a risk that the employee may not receive the information in paragraph 3 from another source?

Q20: Although the draft regulations make no change to paragraph 10 of schedule 2, would further details of where the opt out notice may be obtained be useful for employees?

Q21: Does amending these paragraphs [16 and 17] of schedule 2 [and consolidating into a new paragraph 18] reduce the practical burden of information requirements for employers?

Q22: Is the new consolidated paragraph 18 clear enough to both types of employee (jobholder and worker) who will need to distinguish whether they fit into paragraph 18(a) or 18(b)?

Q23: If the actual figure for qualifying earnings under section 13(1)(a) PA 2008 is not provided in the statement in paragraph 18, is there a risk that employees will not understand the requirements and may stay out of pension saving?

Q24: Does the removal of paragraph 25 strike the right balance between reducing the load on employers and placing the onus on the employee to find out more information about pension saving?

Q25: Is the aspiration of 3 communications realistic and workable?

Q26: Will the overall proposed changes to the information requirements bring simplicity to the automatic enrolment process and with it a reduction in administration and costs for employers? If so, what is the average saving for an employer due to a reduction in the administrative burden?

Q27: How many employers do you think will take advantage of these changes?

Q28: Can these changes be communicated to employees within existing material?

Q29: Is there any risk that the overall consequence of these amendments may cause confusion or detriment to the employee?

Responses to the Consultation

The overwhelming majority of those that responded were generally supportive of the proposed changes to the information requirements and of the intention to simplify and reduce the administrative burdens on employers. A significant number thought most employers would take advantage of the changes, particularly those yet to stage. However, none of the responses were able to quantify numbers or the actual savings.

There were mixed responses as to whether the alternative information requirements could be communicated to employees using existing material. A number of responses, however, indicated that it would be relatively easy to make the necessary changes to use the alternative requirements. Respondents felt this was not generally an issue for employers later in the staging timetable and some others expressed the view that employers who had already staged will find it easy to make changes where it was beneficial for them to follow the new requirements.

There was a majority view that the reduced information requirements could introduce a risk of confusion or detriment to some workers; however, of those who said there was such a risk, the majority said it was low.

The responses also generally thought the aspiration of 3 communications to be realistic and workable. The move to streamline both the quantity and content of the communications that employers are required to provide has been welcomed. The majority of respondents said employees will generally still receive the information they need at the right time, although some may receive it earlier than necessary and may place an added onus on them to understand when it applies to them.

A number of respondents indicated that these changes were a welcome start but were relatively minor and we could go further with simplifying the process for employers. Responses were mixed as to whether the changes alleviate the need for employers to continually assess their workforce and facilitate one individualised communication which suits all circumstances.

Some respondents sought clarity around whether employers could continue to follow the existing requirements thus allowing them to use their current systems rather than having to introduce new ones to comply with the new, streamlined requirements.

A few responses highlighted the importance of the role of the Pensions Regulator for small employers in providing guidance and templates.

Only one respondent objected to the proposed changes noting that the needs of employers and employees in the information process must be carefully balanced. Their view was that the greater need falls on the side of employees, so they did not support the reduction of communication to them. They thought the changes would leave some individuals confused and disengaged from pension saving. For this reason they argued that workers should continue to be given at least the same tailored and individual information that they are now. These views highlight the difficulties in achieving the right balance between simplifying and reducing burdens

for employers and the need to protect the interest of employees whilst ensuring automatic enrolment continues to be a success.

The proposal to remove the information requirement under Regulation 33 provided to workers who are existing members of a qualifying scheme was seen as a welcome easement for employers and the majority of respondents also said it serves little purpose and can be removed without any risk to employees.

The proposed removal of both paragraphs 2 and 3 of schedule 2 to the 2010 regulations was generally thought to help with individualised communications. In particular, the information in paragraph 3 is likely to be provided by the scheme provider. Some respondents commented, however, that removing the date of enrolment in paragraph 2 is likely to trigger questions from the worker or encourage them to opt out through lack of understanding. If the worker is expected to start contributing to a pension it should be clear to them when this will start.

The majority of respondents were generally supportive of the other amendments to schedule 2. The majority of responses indicated there was no desire for further details of where the opt out notice may be obtained, and thought current wording in paragraph 10 to be sufficient.

The area that generated the most responses was the new consolidated paragraph 18. The aim to simplify and reduce the employer burden was welcome. The reference to the legislation in that paragraph was, however, seen as unhelpful to employees, particularly if the actual minimum earnings figure was not required to be included in the statement. Respondents were concerned that this may lead to unnecessary queries directed at the employer and/ or pension provider, or may disengage employees from the content and potentially discourage pension saving.

A few respondents also highlighted the fact that the proposed changes mean that individuals would not necessarily get more information when they change status. For example, where an individual changes status from a worker without qualifying earnings to a non-eligible jobholder, they might not get further information about opting in.

A small minority of respondents opposed the removal of paragraph 25 about where to obtain further information about pension savings for retirement, but the overwhelming view was that this could be removed.

Government Response

The Government welcomes stakeholder support for the proposed changes to the information requirements and the intention to simplify and reduce the burdens on employers. Given only one respondent objected to the overall aim of these measures we are therefore minded to make the proposed changes to the information requirements as outlined in the consultation, subject to the changes referred to below.

The Government wishes to make it clear that employers can continue to comply with the current information requirements and use existing systems if that is easier and/or more cost effective do so.

The Government acknowledges that the changes proposed will not remove the need for continuous assessment in all circumstances. For example, individuals who are not members of a pension scheme will still need to be assessed in each pay reference period to check whether they have become eligible for automatic enrolment. However, the proposed changes do cut back the amount of on-going assessment required. They also reduce the number of separate communications that employers need to send to workers.

The Government has decided that there is merit in retaining paragraph 2 of schedule 2 to the 2010 regulations, which requires the employer to state the employee's automatic enrolment, re-enrolment or enrolment date, but accepts that paragraph 3 is not needed.

The Government has listened to the large number of responses suggesting that the actual figure for qualifying earnings should be given in paragraph 18 rather than just a reference to section 13(1)(a) PA08. Providing the figures will aid an individual's understanding of the information so that they can understand how it applies to them more easily.

Given employers can easily retrieve the relevant figures from the Pension Regulator's guidance on their website, we agree that there is merit in requiring the actual figure to be stated and have amended the regulations to ensure that employers are required to include the actual amount of qualifying earnings specified in section 13(1) of the 2008 Act in both paragraphs 18(a) and (b) of Schedule 2.

We also think there is merit in the suggestion to add that the employee is not entitled to employer's contributions in paragraph 18(b), which is a simple change that adds useful clarity for the individual. This is a mirror reference to the entitlement to an employer contribution in paragraph 18(a) of Schedule 2.

We are prepared to accept that where paragraph 18 is communicated on a single occasion to a worker or jobholder there is a risk that where an individual changes status after staging, they would not get, for example, further information about opting in when they move from a worker to a jobholder (and vice versa). However, we take the view that paragraph 18(a) and (b) together provide the employee with all the information needed to cover the different situations he or she may find themselves in. If they change status at a later time, a different paragraph might apply to them but they should have already received the relevant information and be aware of their different entitlements as worker and jobholder.

From a policy perspective we are of the view that the risk of not requiring an employer to inform an individual of their right to opt-in or join following a change of circumstance is sufficiently low compared to the on-going monitoring requirement for an employer, which we are trying to diminish with the rest of these changes.

The Pensions Regulator has made arrangements, including amending the employer guidance and letter templates, to communicate the messages about the changes to the information requirements in the most appropriate way for different employers.

Exceptions to the employer duty

Background

It became apparent during the early days of live running that pension saving, or further pension saving, may not be appropriate for everyone. In its response to the March 2013 consultation on technical changes to improve the operation of automatic enrolment, the Government expressed the view that there was a strong case for excepting from the automatic enrolment requirement individuals:

- who are leaving employment;
- who cancel membership of a pension scheme before automatic enrolment;
- with tax protected status for existing pension savings.

The PA14 inserted a new section (87A) into the PA08. It allows us to prescribe exceptions to the employer duty so that in certain situations an employer is not required to automatically enrol certain workers. This is achieved by turning some or all of the employer duties into an employer power in certain circumstances.

Section 87A also allows us to modify any of the enrolment or joining processes and turn the duties back on if the circumstances that triggered the exception come to an end. The detail of how we intend to use these provisions is set out below.

Jobholders leaving employment

What the consultation asked

Q30: Do you think that this exception [where notice of termination of employment has been given], [will be helpful] particularly for small and micro employers? If not, why not?

Q31: How many employers do you think will take advantage of this exception?

Q32: Can this exception be communicated to employees within existing material?

Q33: Can you foresee any difficulties with removing opt-in rights during notice periods for either employers or individuals?

Q34: In your experience, how frequently is notice withdrawn? Do you think that turning the duty back on in withdrawal cases will cause any problems for employers or employees? If not, why not?

Q35: Do you think that this exception should be extended to other 'end of employment' situations, for example where a fixed term contract is coming to an end? What do you think the advantages or disadvantages would be to this approach?

Responses to the consultation

The majority of respondents felt that this was a helpful exception to employers of all sizes. Respondents told us that this exception would reduce the unnecessary bureaucracy and cost of setting up pensions for people who will shortly be leaving their employment. Another welcome factor reported was the reduction in the number of small pots.

Some respondents pointed out that some large employers may have to update their systems in order to take advantage of this exception. This added weight to the argument that this exception should be permissive although there were some respondents who thought that giving employers a choice could add complexity. The need for simple guidance was a theme that ran through these comments.

One respondent felt that the exception might allow employers to avoid their duties and suggested that it should be restricted only to cases where a jobholder had given notice. Several respondents asked for clarity on how the notice needs to be given and how it works for zero hours contracts.

Most respondents thought that the exception could be communicated within existing material although a number of respondents pointed out that this will vary from employer to employer.

With regard to the removal of opt-in rights, most respondents did not foresee any difficulties and felt that any financial loss to jobholders would be very small. However one respondent thought that this could lead to artificially long notice periods.

Respondents were not able to tell us how frequently notice was withdrawn but nearly everyone who answered this question thought it to be an infrequent occurrence. Most agreed that in these rare cases the duty should be turned back on to avoid abuse.

There was a mixed response to the question of whether this exception should be extended to the other end of employment situations, such as fixed term contracts. Those who supported an extension felt that it would simplify matters for employers e.g. where the type of contract was not held on the payroll system or where postponement could not be used. Those who opposed an extension pointed to the risk of abuse and the fact that fixed term contracts are often renewed potentially leaving someone out of pension savings for a considerable period of time.

Government Response

The Government welcomes the fact that most respondents thought this a helpful exception.

Whilst the Government agrees to a certain extent that some employers could attempt to use this exemption to avoid their AE duties we do not perceive this risk to be particularly high, particularly given that the duty will be re-instated where notice is withdrawn. We think that restricting the exception to cases where the jobholder instigated notice would be disproportionate to the risk but will keep this issue under review.

In response to calls to make this a mandatory exception, the Government remains of the view that it should be permissive. We want to avoid placing a requirement on employers who have already staged as well as intermediary organisations from having to update HR processes and automated assessment tools.

The Government has considered whether or not to extend to the other end of employment situations but thinks that the risks to individual jobholders outweigh the benefits for employers.

Cancelling membership of a scheme prior to automatic enrolment

What the consultation asked

Q36: Do you think this exception [for those who have left a qualifying scheme] will help to simplify the automatic enrolment process for employers, particularly small and micro employers?

Q37: Do you agree that applying this exception to all people who have left a qualifying scheme (as opposed to just contract joiners) will simplify the process for employers?

Q38: Can you foresee any negative consequences for employers or employees?

Q39: Do you think that 12 months is a suitable timeframe for restricting the exception?

Q40: How many employers do you think will take advantage of this exception?

Q41: Can this exception be communicated to employees within existing material?

Q42: Do the benefits of this exception outweigh the risks of people being left out of pension savings for up to 3 years?

Responses to the consultation

Most respondents thought this would be a helpful exemption, particularly for larger employers who are more likely to contractually enrol their employees. Most agreed that this should be a permissive exception as some employers will find it easier to automatically enrol all jobholders when the duty arises.

A number of respondents felt that this exception needed to go further to be of real benefit to employers. It was pointed out that it could introduce a monitoring requirement for employers because some employees could become an eligible jobholder once 12 months had elapsed but before automatic re-enrolment. This concern was echoed in the responses to question 39 on a suitable timeframe.

There was also a question seeking clarification on the definition of “active member” and “qualifying scheme” and a suggestion that an employer must have staged before a scheme could be qualifying.

Some respondents expressed concern that eligible jobholders could potentially be out of saving for up to four years; however, most thought that the benefits of this exemption outweighed the disadvantages.

Government response

The Government accepts the need to reduce the monitoring requirement of employers as much as possible. We have clarified the provisions so that it is clear that where a worker or jobholder cancels membership of a qualifying scheme, during the 12 month period following that event, the employer has a discretion to enrol or re-enrol the worker. After that 12 month period, the duty to enrol is lifted until the next automatic re-enrolment date. The 12 month rule therefore also applies where a jobholder cancels membership within 12 months of automatic re-enrolment. Accordingly, if the employer staged during or after the 12 month period following a worker's cancellation of his or her membership, there would be no duty to automatically enrol that worker until the next cyclical re-enrolment date.

In response to questions seeking clarification on the circumstances where this applies, we have decided to further simplify the measure by applying the exception to anyone who cancelled membership of a qualifying scheme be they a worker, non-eligible jobholder or eligible jobholder at the time of cancellation. We have amended the regulations to make it clear that for this provision to apply, the scheme must be considered qualifying in relation to the worker as if they were a jobholder. Employers do not have to have staged at the point active membership[3] was cancelled for the scheme to be considered a qualifying scheme. This is an objective test which may be met by the scheme at any stage prior to or after the staging date.

Individuals with tax protected status

What the consultation asked

Q43: Do you think the exception [for individuals with tax protected status] should be this wide or restricted to certain protections, for example only where further pension accrual could jeopardise an employee's tax status?

Q44: Will the proposed exception as drafted help reduce the administrative burden and costs for employers by allowing these employees to be kept out of the automatic enrolment process altogether? If so, what is the average saving for an employer due to a reduction in the administrative burden?

Q45: How many employers do you think will take advantage of this exception?

Q46: Can this exception be communicated to employees within existing material?

Q47: Is the proposed exception a welcome easement for employees who have tax protected status?

[3] "Active member" is defined in section 99 of PA08.

Q48: Does the benefit of having this exception for employers outweigh the risk to employees receiving no information about their right to opt in?

Q49: Does placing the onus on the employee and the proposed changes to HMRC and TPR guidance sufficiently deal with the practical problem of the employer knowing of the individual tax status as well as what the employee needs to do?

Responses to the consultation

The vast majority of responses agreed that it is not appropriate for employers to automatically enrol an employee who is protected from tax charges under enhanced or fixed protection provisions given these are not the target audience for automatic enrolment. Removing the requirement to automatically enrol and provide information to employees with tax protected status who would then need to opt-out provides for a simpler and more efficient process for both the employee and employer.

The majority of responses also agreed the exception should be as wide as proposed even though employees with primary or individual protection do not lose their tax protected status due to further pension accrual. It has been suggested that the list of the various tax protections need to be kept under review and will need to be amended if in future there are further changes to the pension tax regime and new types of tax protections arise.

Only one respondent suggested that this exception should not be included at all. On the basis that it potentially places a duty on employers to safeguard the personal tax situation of their employees. In their view it is not unreasonable that an employee that has gone to the lengths necessary to acquire protected tax status should bear some responsibility for maintaining it.

The majority of respondents were unable to quantify the reduction in costs in terms of reducing the administrative burden for employers. Some thought there may be an initial cost involved in using this flexibility. The overwhelming view, however, was that employers with employees who have tax protected status will take advantage of the exception. Overall respondents considered the benefit of having the power to exclude such an employee from their enrolment duty outweighs the time and expense in enrolling these employees.

There were mixed responses as to whether the exception could be communicated to employees using existing material. There were, however, a number of responses indicating it would be relatively easy to make the necessary changes. One respondent made the point that given the higher than average level of financial and pension knowledge amongst these individuals, they did not believe that it would be

necessary to include within existing communication material. In addition, a couple of responses confirmed that the existence of HMRC guidance means additional communications were not necessary.

Of those that responded the overwhelming view was that this easement will be welcomed by employees as it will remove the inconvenience of opting out and the risk of an affected employee not doing so. It was also the vast majority view that the benefit of having this exception for employers outweighs the risk to employees receiving no information about their right to opt in given they are more likely to be aware of their pension choices either with or without seeking financial advice. That said a few responses pointed out that the information requirement about the right to opt in has not been fully turned off under the revised Regulation 21 of SI2010/772 and new Regulation 5D.

A significant majority of responses confirmed the onus should be on the employee to notify their employer of their tax protected status. An employer would not know this information and therefore this is a proportionate approach. There is also still the failsafe provision of the member being able to opt out if they are automatically enrolled.

A few responses highlighted how essential updating HMRC and TPR guidance will be in order to make this exception work as intended. This was also referred to in a few responses that raised questions around what is actually meant by “reasonable grounds”. Respondents wanted protection for employers against the risk of an employee seeking to blame the employer for any loss if he is auto-enrolled and loses tax protection. This would particularly apply in the future where an employee may just assume he would not be auto-enrolled because he has been excluded before.

<u>Government Response</u>

The Government welcomes the fact that the majority of respondents agree this exception is appropriate and for it to cover the full range of tax protections. We will, however, keep the list of the various tax protections under review.

We will work with colleagues in HMRC to ensure their guidance is appropriately amended as stated in the consultation document so workers are aware of the exception and what needs to be done. The Pensions Regulator will also update their employer guidance to reflect this exception when talking about the employer duties.

The Government agrees with the vast majority of respondents that the onus should be on the worker to notify their employer of their tax protected status. We also want to provide some flexibility for workers and employers and so we are not minded to change from the employer having “reasonable grounds” to believe their employee

has tax protected status. A copy of the HMRC certificate is one such way to demonstrate reasonable grounds.

Although we originally proposed that there should be no information requirements for these workers as part of the consultation, the Government is grateful for the respondents who pointed out that the wording of the revised regulation 21 and new 5D mean that there is still an information requirement to tell these workers about opting in/joining, and, on reflection, given we have retained the right to opt-in and join we see no reason to change the legislation as drafted.

The employer will still have the power to enrol all eligible workers regardless of whether or not those employees have tax protected status, if it is easier and more cost effective for them to do so.

Winding up lump sums (WULSs)

What the consultation asked

Q50: Do you think this exception [for those who have received a winding up lump sum] provides a useful easement for employers as well as a sensible protection from unwanted tax charges for the employee?

Q51: How many employers do you think will take advantage of this exception?

Q52: Can this exception be communicated to employees within existing material?

Q53: Does the benefit of having this exception for both the employer and employee outweigh the risk of some people being left outside of pension saving for a period of what could be 3 years?

Q54: Does the benefit of having this exception outweigh the risk to employees receiving no details or confirmation of their employer's lawful decision not to automatically enrol them?

Q55: To what extent are WULSs being paid out by employers to employees who continue to be employed by them? If they are why, having regard to the tax rules on paying WULSs?

Responses to the consultation

Although not a common situation or a known significant issue, of those that responded the overwhelming majority confirmed this exception would be a welcome easement for employers as well as a sensible one in terms of protecting employees

from unwanted tax charges. Where such a situation exists responses indicated that employers would take advantage of such an exception, although none were able to quantify the extent.

A small number of responses pointed out that as drafted Regulation 5E would not achieve the policy intent as this needs to be amended to reflect the fact that a winding up lump sum is not paid by an employer but usually by the trustees or scheme provider depending on the type of scheme.

Respondents indicated that this exception cannot be communicated to employees within existing material. The responses, however, suggested that it does not appear necessary to communicate this change to employees generally. Should it be beneficial to an employer to take advantage of this exception then responses suggest there are ways of communicating this that are not overly burdensome to an employer.

The majority of responses confirmed that the benefit of having this exception for both the employer and employee outweighs the risk of some people being left outside of pension saving for a period of what could be 3 years. This risk is also mitigated as an individual can opt-in after 12 months from the time the WULS is paid. That said, a few responses suggested the guidance/communications around this provision need to be clear about the implication for employees, some of whom may be part of the target audience for automatic enrolment. The same proportion also said the benefit of having this exception outweighs the risk to employees receiving no details or confirmation of their employer's lawful decision not to automatically enrol them.

A couple of responses picked up on the fact that the draft regulation retained the joining right but not the right to opt-in. The joining right was retained as there is no employer contribution element required to invalidate the undertaking given to HMRC. However, one respondent pointed out that to retain the joining right may have disproportionate cost implications for an employer who may have to set up another scheme for what may be one employee who wishes to join.

Of those that responded to the question asking to what extent WULSs are being paid out by employers to employees who continue to be employed by them, the overwhelming responses indicated that such WULSs are not being paid. Only one response indicated there was a possibility of such a WULS being paid in a specific circumstance, which may be years after a scheme has closed.

<u>Government Response</u>

Although not a common occurrence, the Government welcomes the fact that this exception would be a helpful easement in the specific circumstances prescribed.

We have listened to the responses that have pointed out that the drafting of Regulation 5E did not meet the policy intent because of how a WULS is paid. We have therefore amended the drafting accordingly.

We will ensure HMRC guidance on WULSs and how they interact with automatic enrolment is amended to help with communicating this change and the Pensions Regulator will also be updating its employer guidance when describing the employer duties.

We originally consulted on the basis of not allowing the right to opt in with an employer contribution as this would have breached undertakings given by the employer to HMRC with adverse tax implications and therefore defeat the purpose of the exception. However, we did retain the joining right as this would not affect the undertaking given to HMRC. This was done with the intention of allowing employees to join who, unlike those with tax protected status, may be part of the core target audience for automatic enrolment. On reflection, however, leaving open such an option could bring a disproportionate cost to the employer of having to set up a separate scheme for that worker without employer contributions.

This may mean an employer setting up a new scheme for what could be a single or a very small number of workers. This would be a disproportionate cost compared to what an individual will gain, which is a 12 month period to put in their own contributions (with no employer contribution), which they could anyway via a personal pension. We consider the risk of such an individual being outside of pension saving for at least 12 months (when they could still pay into a personal pension) very low compared to the disproportionate cost to the employer of setting up a new scheme for what may be one individual. We have therefore decided to remove the right to join under section 9 of PA08 in these circumstances.

Having regard to the responses, the Government is still of the view that we do not need to provide for an exception to the duties where a WULS is paid out to existing employees who continued to be employed for the reasons we set out in the consultation document.

Taking a pension income using Flexi-access Drawdown

What the consultation asked

Q56: Do you think an exception for employees who flexibly-access their pension rights would be welcomed by employers or considered appropriate given the proposed changes to the tax rules from next April?

Responses to the consultation

The overwhelming response to this question was that such an exception is not appropriate given the changes to the tax rules coming in from April 2015. A number of responses also confirmed that this type of exception could also place unwanted burdens on employers with having to consider information provided to them by the employee and to come to a decision of whether or not to enrol.

Government response

In light of the responses the Government remains of the view that it is not appropriate to legislate for an exception for employees who access their pension rights flexibly. Some of these individuals who may flexibly-access their pension rights may be relatively low earners who are part of the target audience for automatic enrolment, and won't have contributions paid that are anywhere near £10,000 so there is no obvious reason for them to be excluded.

Effect of the exercise of a discretion

The draft regulations we consulted on currently provided for a modification to ensure that where the employer has the power to automatically enrol or re-enrol and chooses to exercise that power positively, the relevant legislation is to be read as if he were discharging an employer duty. Accordingly, he may therefore be enforced against in relation to those duties.

We received a couple of responses indicating this needs further clarification. On reflection we agree this regulation could be further clarified so we have changed the wording to make it absolutely clear that where an employer decides to exercise his discretion positively to automatically enrol a worker or makes the arrangements in section 7 or 9, he is to be treated as if he were acting under a duty.

Annex A

List of Respondents

Aon Hewitt
Aquilaheywood
Association of Accounting Technicians
Association of Consulting Actuaries
Association of Convenience Stores
Association of Member Nominated Trustees
Association of Pensions Lawyers
Association of School and College Leaders
Aviva
Barclays Bank
Benchmark Software Ltd
British Airways
British Chambers of Commerce
British Telecom
Church of England Pensions Board
Compact Software
Confederation of British Industry
Department of Health
Devon County Council
Eversheds
Friends Life Group Ltd
Hargreaves Lansdown
Hymans Robertson LLP
Institute and Faculty of Actuaries
Institute of Chartered Accountants England and Wales
Jaguar Land Rover
Legal & General
Local Government Association
Low Incomes Tax Reform Group
Mercer's
National Association of Pension Funds
National Farmers Union
NEST Corporation
NHS Employers
NOW:Pensions
Pennon Group plc

Royal Bank of Scotland
Sacker & Partners LLP
Scottish Qualifications Authority
Society of Pension Professionals
Standard Life
Syngenta Limited
Tax Incentivised Savings Association
The Chartered Institute of Payroll Professionals
The Pensions Advisory Service
The Pensions Trust
Towers Watson
Transport for London
Universities & Colleges Employers Association