Leaflet 3 | June 2012

NAPF

Securing the future of pensions

New rules for pension saving made simple

What are my pension scheme options?

The first two leaflets in the 'new rules for pension saving made simple' series explained you must automatically enrol most of your employees into a pension scheme and when you need to do this.

You can use an existing pension scheme, if it meets certain conditions, and/or set up a new scheme or schemes.

You don't have to put all your employees into the same scheme
(but to avoid claims of discrimination or industrial relations problems it's best to seek advice if you want to treat groups of employees differently).

The new rules are likely to have far-reaching financial and operational implications for most employers and so you need to make sure you select carefully. You may even decide these changes create an ideal opportunity to review your existing pension and reward arrangements.

This leaflet discusses what you need to consider when it comes to choosing a scheme(s).

A quick reminder...

You must automatically enrol **Eligible Jobholders** into an **Automatic Enrolment Scheme** EXCEPT if they are already active members of a **Qualifying Pension Scheme**.

If **Non-eligible Jobholders** want to join the **Automatic Enrolment Scheme**, you have to enrol them too EXCEPT if they are already active members of a **Qualifying Pension Scheme**.

Although **Entitled Workers** have the right to join you do not have to pay employer contributions for them but you do need to make sure:

- the scheme they join is registered for tax purposes; and
- you deduct employee contributions and pay these over to the pension scheme.

Need to re-visit the terms?

Eligible and **Non-eligible Jobholders** and **Entitled Workers** are explained in **Leaflet 1 – What are the new rules?**

Automatic Enrolment Scheme and **Qualifying Pension Scheme** are explained in **Leaflet 2 – What do I need to think about?**

I think I will use my existing scheme – what do I need to do?

Step 3 Finally make sure the scheme(s) you want to use is a **Qualifying Pension Scheme**.

Step 2 Check what type of pension scheme you have. **Diagram 1** on page 3 shows the typical schemes employers use. You will need to know if your scheme is **DB** or **DC** or a mixture of both (these terms are explained in **Leaflet 1 - What are the new rules?**). If you are not sure get your scheme managers to confirm this for you.

Step 1 Identify the categories your active scheme members fall into (these are the members who still work for you) **Leaflet 1 - What are the new rules?** explains employee categories.

Are there additional requirements if I want to use a DB scheme?

Yes, the law requires your **DB** scheme to be **Contracted-Out** (a term which is discussed later in this leaflet). If your **DB** scheme is not **Contracted-Out**, its benefits have to be of a minimum standard (known as the **Test Scheme Standard**) which means they have to be broadly equivalent or better in the areas listed in **Box 1**.

Does the type of DB scheme I have make any difference?

DB

Many DB schemes are known as Final Salary schemes which simply means they include salary at or near retirement, leaving or death in the formula used when calculating benefits.

A Career Average Revalued Earnings (CARE) scheme is where the formula for calculating benefits uses average earnings throughout scheme membership. This average will receive increases (known as revaluation) to allow for the impact of inflation.

If you want to use a **CARE** scheme you should know there are a few extra rules which cover how you must **revalue** benefits while your employee is still a member of your scheme.

1. **Revaluation** should be at least equal to the annual increase in the **Consumer Price Index (CPI)** capped at 2.5%.
2. If **revaluation** is provided on a discretionary basis the funding for the scheme must assume the increase will be paid as indicated in (1) above.

The scheme's **Statement of Funding Principles** (the formal document which sets out how a scheme intends to fund its benefits) must also reflect this.

Box 1

Test Scheme Standard

- The right to receive a pension from age 65, which must continue for life. (This will gradually rise to age 68 as State Pension Age increases.)
- The formula used to calculate the annual pension must be broadly equivalent or better than:
  - 1/120 x years of **pensionable service** (maximum 40 years) x average **Qualifying Earnings***

  ***Qualifying Earnings** can be the average earnings in the 3 tax years before scheme membership ends and are explained in **Leaflet 2 - What do I need to think about?**
- Pensions in payment must receive an annual increase at least equal to any rise in the **Consumer Prices Index (CPI)**, which can be capped at either 5% or 2.5%.
- If scheme membership ends early a **deferred benefit** may apply (ie a benefit calculated at the date membership ends but payable at a future date).
- The law requires most **deferred benefits** to be increased annually until they are paid. This is known as **revaluation of deferred benefits**.

FIND OUT

The people who run your **DB** pension scheme can help you check if your scheme benefits meet the **test scheme standard** and explain:

ABOUT

1. The level of **revaluation** given to your **deferred benefits**.
2. The cap that is applied to the increases for your pensions in payment.
3. What counts as **pensionable service** in your scheme.

I think I have a Contracted-Out DB scheme

If your **DB** pension scheme is **Contracted-Out** of the **S2P** (see **Box 2**) the people who run your scheme should have a certificate confirming this from the National Insurance Services to the Pensions Industry (NISPI) part of HM Revenue and Customs. If you have a certificate your scheme benefits will meet the **test scheme standard**.

Box 2

Contracted-Out DB schemes

Pension schemes where a choice has been made not to make scheme members also contribute towards the **State Second Pension (S2P)** (previously known as **SERPS**). In these circumstances both the individual and their employer pay less National Insurance contributions which compensates for the scheme member not receiving **S2P**.

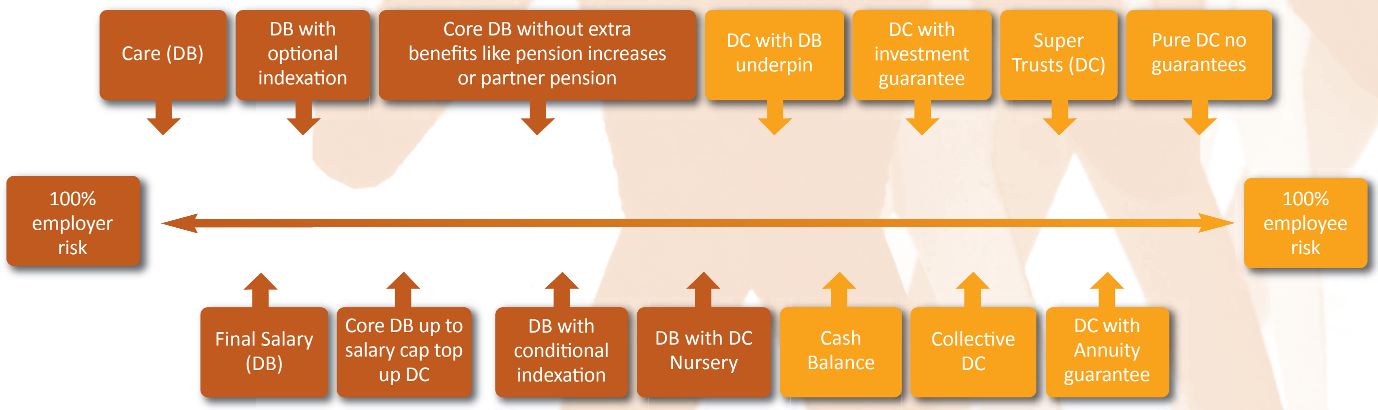
What if I want to set up a new scheme?

There are a number of key factors to consider when choosing a pension scheme.

First you have to decide how you are going to set up your scheme eg by trust, contract or by participating in a **Master** or **Super Trust** (**NEST** is a form of **Super Trust**). These key methods are all described on the next page of this leaflet.

Next you need to decide if your scheme is to be **DB** or **DC** or a mixture of both. **Diagram 1** shows the wide range of schemes that employers generally use.

Diagram 1



Finally you need to decide what features your scheme(s) should have. While many workplace pension schemes offer additional features, for example, life assurance or other risk benefits, the new rules for pensions saving don't require you to do this. The features your scheme will have depend on whether you choose a provider's standard scheme or have one tailored specifically for you to use. The features of the four main types of scheme employers are likely to use to satisfy the new rules on pension saving are shown below.

Key methods used to set up pension schemes

***Trust-based schemes* – DB** or **DC** schemes set up by an employer using a separate trust. The terms of the scheme will usually be contained in a trust deed. There will be one or more trustees responsible for delivering the terms of the trust.

- ***Super Trusts* –** A not-for-profit arrangement established under trust to provide (mainly) **DC** pension rights for the employees of more than one employer.
- ***Master Trusts* –** Similar to **Super Trusts** but are commercial products.

- ***Contract-based DC schemes* - DC** pension schemes set up by contract between the employee and a provider. The provider is selected by the employer. Includes **Group Personal Pensions (GPPs)**.
- ***Personal Pension schemes* - DC** arrangements set up under a contract between the provider and an individual. **Stakeholder** and **Self Invested Personal Pensions (SIPPS)** are types of personal pension schemes.

Features	Trust Scheme	Master Trust	Contract Scheme	NEST
Trustees have a legal responsibility to manage the scheme	✓	✓		✓
No legal requirement to manage the scheme although voluntary management committees are often established			✓	
Higher rate tax payers receive tax relief under PAYE	✓	✓		
Short service refunds of employee contributions	✓	✓		
Small pensions can be taken as cash	✓	✓	✓	✓
Transfer of benefits in and out of the scheme	✓	✓	✓	
No contribution limits	✓	✓	✓	
Control over the scheme's investment strategy	✓	✓		
Employer branding of the scheme can apply	✓	✓	✓	
Minimal involvement required from the employer		✓	✓	✓
Separate scheme needed for life assurance benefits			✓	✓
Death benefits paid as cash are not subject to Inheritance tax (IHT) (subject to trustees having discretion to pay benefits)	✓	✓	✓	
Pension saving can continue if the employee leaves employment			✓	

What are the rules for contributions?

As part of the conditions for a **DC** scheme to count as a **Qualifying Pension Scheme** the scheme rules (or other agreement setting out how the scheme works) must state

- the employer will pay contributions for employees who are automatically enrolled;
- once the **Phasing-in*** of contributions ends on 30/09/2018, total employee and employer pension contributions cannot be less than 8% of **Qualifying Earnings**, in each pay period; and
- employer contributions cannot be less than 3% of **Qualifying Earnings** in each pay period.

***Phasing-in** is explained in **Leaflet 2 - What do I need to think about?**

While many of the schemes used to accommodate the new rules on pension saving are likely to be **DC**, as mentioned previously in this leaflet, **DB** schemes can be used too. Whatever type of scheme you choose you must make sure you pay contributions on time.

If a personal pension scheme is used an agreement must be reached between the employer, employee and the provider of the personal pension covering minimum contributions and the arrangements for paying over contributions to the provider.

Payment of Employer Contributions

Employer contributions have to be paid over to the pension scheme by the date set out in the pension scheme's Schedule of Contributions (DB) and Schedule of Payments (DC). The people who run your pension scheme should be able to confirm the date for your scheme

Employee deductions

Once an employee's pension contributions have been deducted from pay they must be paid to the pension scheme by the 19th of month following the month in which they were deducted. If payment is made electronically this can be extended until 22nd day

What happens if an employee Opts-out?

Employees have a period of time (known as their **Opt-out period**) to opt-out of pension saving once they have been automatically enrolled. The length of the **Opt-out period** is determined by more than one factor and so may not be the same for every employee.

Where pension contributions have been deducted during the **Opt-out period** contributions don't have to be paid over to the pension scheme until the end of the 2nd month following the date on which the employee was automatically enrolled into the pension scheme. The procedures for **Opting-out** are discussed in **Leaflet 4 - Will I need to change how I do things?**

What if I want to use Salary Sacrifice?

There are a few things to think about if you want to continue to use **Salary Sacrifice**.

1. You can't make signing up to **Salary Sacrifice** a condition of membership of an **Automatic Enrolment Scheme** or **Qualifying Pension Scheme**.

2. If you want to use **Salary Sacrifice** you normally have to ask each employee to agree to it ***before*** you automatically enrol them or, where **Opting-in** applies, ***before*** they are eligible to join. If it helps you may want to consider postponing enrolment dates if this gives you more time to gain agreement. **Postponement** is discussed later in this leaflet.

3. If an employee does not want to use **Salary Sacrifice** or fails to respond to your request to use **Salary Sacrifice**, you have to deduct pension contributions as prescribed in the new rules for pensions saving. (See **Leaflet 2 - What do I need to think about?**)

Salary Sacrifice

This is a contractual arrangement between employer and employee.

The employee's pay is reduced before he or she receives it and a corresponding sum is paid by the employer into the pension scheme.

Both the employee and employer save Tax and National Insurance on the amount sacrificed.

In **DC** schemes **Qualifying Earnings** are assessed using salary after it has been reduced.

Is it different if my pension scheme is part of a contractual agreement?

Yes. You can continue to use a pension scheme which uses **Salary Sacrifice** provided it is part of a contractual agreement between you and your employee and it meets the requirements for a **Qualifying Pension Scheme**. If your scheme does not qualify you not only have to fully introduce the new rules for pension saving but if you want to use **Salary Sacrifice** as part of this you will have to follow the process for non-contractual schemes mentioned at 1 to 3 on Page 5 of this leaflet.

What happens if I offer a flexible benefits package?

You can continue to offer flexible benefits but you also have to comply with the new rules for pension saving. Those employees who you are required to enrol automatically must be enrolled from the correct date. And If you use a **defined contribution (DC)** scheme you have to make sure you and your employee pay the minimum contributions.

After you have enrolled your employee he or she is free to reduce or increase the level of contributions to the pension scheme and use them instead to secure other benefits under your flexible benefit scheme.

Flexible Benefits

Some employers offer a range of employee benefits which may or may not include pension scheme membership. For example, healthcare, life assurance, cash. Flexible benefits schemes allow workers some freedom of choice about how they apportion their total pay and benefits. Traditionally, these schemes allow workers to choose what level of pay is committed to pension contributions alongside other benefits.

You will need to revisit any decision made by employees not to pay the minimum contribution levels required under the new rules for pension saving, (broadly) every three years. This is because the employee is effectively **Opting-out**. (See **Leaflet 4 - Will I need to change how I do things?** which explains **Opting-out**.

Postponing the introduction of the new rules

Whatever type of scheme you use to satisfy the new rules for pension saving you can to put-off automatically enrolling employees for a period of up to three months. You can however only postpone certain dates:

- your **Staging Date** (see **Leaflet 1 - What are the new rules?**) for employees already employed on this date;
- the first day of employment, for any employee starting employment after your **Staging Date**; and
- the date an employee meets the criteria to be an **Eligible Jobholder** after your **Staging Date**.

If you intend to use a **DB** scheme you might be able to delay the introduction of the new rules for longer than three months ie until 2017. This extension is, however, only applicable to certain categories of employees.

As there are a lot of issues to consider if you decide to postpone the implementation of **Automatic Enrolment**, not least your processes and procedures, **Leaflet 4 - Will I need to change how I do things?** discusses postponement in more detail. It also reviews some other changes you may need to make.

What do I need to do now?

1. Decide if I am going to use an existing pension scheme or set up a new one.
2. Decide if I am going to use the same scheme for all my employees.
3. If I am going to use an existing scheme (s), check what type it is.
4. Check if any existing pension scheme(s) meet the **Qualifying Pension Scheme** requirements. Seek advice to make absolutely sure.
5. Read **Leaflet 4 - Will I need to change how I do things?**

Other sources of information

There is a variety of information about the new rules for pension saving on websites:

Direct Gov - **www.direct.gov.uk** The Department for Work and Pensions - **www.dwp.gov.uk**
The Pensions Regulator - **www.thepensionsregulator.gov.uk**