First Briefing, February 2018
Auto enrolment – contribution phasing

Introduction

When auto enrolment was introduced in 2012, the government set minimum contribution levels that would increase over time. This is known as “contribution phasing” and, although the increases have been delayed, the first increase will now take place on 6 April 2018 with the second increase coming along a year later.

What are the new rates?

The table below shows the minimum contributions for each pay basis under auto enrolment, and how they increase over time.

		Up to 5 April 2018		6 April 2018 to 5 April 2019		From 6 April 2019	
	Earnings definition	**Employer**	**Total**	**Employer**	**Total**	**Employer**	**Total**
Minimum compliant rates	Qualifying earnings	1%	2%	2%	5%	3%	8%
Set 1	Basic	2%	3%	3%	6%	4%	9%
Set 2	Basic *	1%	2%	2%	5%	3%	8%
Set 3	Gross	1%	2%	2%	5%	3%	7%

* where basic salaries must, in aggregate, be at least 85% of gross earnings.

Member communication and consultation

The effective minimum employee contribution is the difference between the minimum total contribution and the minimum employer contribution. So, for example an employee currently contributing 1% of qualifying earnings will see their contribution treble to 3% of qualifying earnings in April 2018.

Although there is no requirement for employers to communicate these changes, given the effect they can have on an employee’s take home pay, it might be a good idea to remind employees that this will be happening.

Prior communication will ensure that members are prepared for the change and should also limit the number of queries received by payroll after the first increased deduction has been taken from their pay.

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Partial payment period for monthly payrolls

This may sound all very simple but this is pensions so, as usual, there are complications. In particular, if an employer is using a payroll cycle that is not aligned to tax weeks or months then, in theory at least, contributions in the pay period that spans 6 April should be based partly on the existing rates and partly on the higher rates.

However, The Pensions Regulator acknowledges that employers' payroll systems may not be able to cope with differing contribution rates in a pay reference period. As a result, they have indicated that they will take a pragmatic approach to the increases being applied as can be seen from the following extract from the Regulator's website:

> *If the employer's payroll does not process pro-rated contributions, the employer, pension provider and payroll provider should agree how best to deduct the amount due.*
>
> *For example, they may agree to apply the contribution rate applicable on the date earnings are paid, so if the pay date is on or after 6 April 2018, contributions for the full pay period are deducted at the increased rate.*
>
> *Alternatively, they may decide to apply the increased rate for any pay period that includes 6 April, even if the pay date is before 6 April.*

Notwithstanding this sensible approach some legal advisers are suggesting that employers wishing to apply the increased contribution rates to the whole of an employee's April pay should consult before doing so.

Members paying reduced contribution rates

While auto enrolment has so far been largely viewed as a success, and opt out rates have been lower than anticipated, no one knows if these higher contributions will result in employees leaving their scheme.

While the increase in contribution rates is a legal requirement, it is possible for the structure of the scheme to allow employees to 'opt down' to a lower level of contributions. While this is not formally set out in the regulations, it is an option that the Pensions Regulator acknowledges can be used.

Therefore, if the contribution structure allows (e.g. there is a structure which has contribution rates below the legal minimums), employees may be able to remain in the scheme and carry on paying their current contributions.

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The Pensions Regulator has stressed that employers must not promote or proactively offer this option. Instead, the Regulator suggests that it may only be offered to individual members, and only in response to them indicating that they wish to leave the scheme because of the increased contributions – thereby keeping them in the scheme when they would otherwise leave.

In addition, any ‘opting down’ of contributions would only be temporary. At the earlier of the employer’s next triennial re-enrolment date and the next phasing date in April 2019, members paying below the legal minimum would need to have their contributions increased to the legislative minimum applicable at that time. The member would then need to opt down again if they still wished to pay less.

This has the potential of being complicated to administer, and therefore organisations considering allowing this may wish to consider whether it is worth the additional administration.

Who can you contact for further information?

Please contact your usual First Actuarial consultant or any of the First Actuarial auto-enrolment team if you would like to discuss anything contained in this Briefing or to do with auto-enrolment generally.

South	North
Antonia Balaam Email: antonia.balaam@firstactuarial.co.uk Tel: 01732 207 517 or 07852 929 804 **Simon Redfern** Email: simon.redfern@firstactuarial.co.uk Tel: 01732 207 577 or 07453 973 174	**Ian Barrett** Email: ian.barrett@firstactuarial.co.uk Tel: 0161 348 7478 or 07490 496 134