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Client Alert
Commentary

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Compulsory Pension Provision in the UK: Some Tricky Issues

Shedding light on some complex issues that can arise with UK auto-enrolment.

In the UK, The Pensions Regulator (TPR) recently published its first report on enforcement action it has taken against an employer for non-compliance with the new employer duties under the automatic enrolment regime. As we have outlined in previous Client Alerts the key duties require employers to automatically enrol eligible workers into a pension plan and pay contributions to that plan in respect of them. In the case in question, the employer was late in auto-enrolling some of its eligible workers, failed to calculate and make the correct contributions to the plan on a timely basis, and provided TPR with incorrect information seeking to "cover up" its failures when completing the compulsory registration process. When TPR began to investigate the matter, the employer was generally co-operative, and this appears to have influenced TPR's decision simply to seek to remedy the non-compliance rather than impose any kind of penalty. TPR's enforcement powers include the ability to fine a non-compliant employer up to £10,000 per day.

In light of this new report by TPR, this Client Alert looks to shed some light on some tricky issues that employers can encounter in connection with their duties under the new regime.

What happens on a TUPE transfer?

The date these employer duties apply to an employer is known as its "staging date", and this is determined by one of two ways:

- The number of workers the employer had in its largest pay-as-you-earn (PAYE) scheme in April 2012 (according to TPR's records), and in some cases the employer's PAYE reference number

- If the employer didn't employ any workers in April 2012, the date on which it first started paying PAYE income

If an employee who meets the conditions for auto-enrolment transfers in connection with a business sale or an outsourcing pursuant to the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE), the date on which the employee is eligible for automatic enrolment will be determined by the "staging date" of his current employer, and this may change when he TUPE-transfers.

For example, if Peter meets the statutory conditions to be auto-enrolled, and he is employed by A Limited before being TUPE-transferred into the employment of B Limited, there are several possible answers to the question of when he will be auto-enrolled:

- If he TUPE-transfers before the staging date of either A Limited or B Limited, Peter will be auto-enrolled with effect from B Limited's staging date.

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- If he TUPE-transfers after A Limited's staging date but before B Limited's staging date, Peter will be a member of a pension plan at the time of his TUPE-transfer, and so his right to participate in a pension plan will be protected by TUPE. If the pension plan used by B Limited to meet its TUPE obligations is not a "qualifying" pension plan for the purposes of the new employer duties, Peter will need to be auto-enrolled by B Limited with effect from its staging date. If, on the other hand, the pension plan used by B Limited to meet its TUPE obligations is a "qualifying" pension plan for the purposes of the new employer duties, Peter will not need to be auto-enrolled on B Limited's staging date, because he will already be an active member of a qualifying plan.

- If he TUPE-transfers before A Limited's staging date, but after B Limited's staging date, Peter will need to be auto-enrolled by B Limited in connection with the transfer of his employment.

What happens on a share acquisition?

If the shares of a corporate employer are sold, the employer's staging date is unaffected.

What are the employer's duties in relation to workers on maternity leave?

The nature of the duties owed by an employer to a particular worker depends on the category the worker falls into. TPR calls the three groups of workers:

- Eligible jobholders

- Non-eligible jobholders

- Entitled workers

The category an individual falls into depends on their level of earnings and their age. This is assessed each payroll period (so a worker with variable earnings, such as a worker receiving maternity pay, may move between categories).

Various protections are given to employees on maternity leave by anti-discrimination law in the UK. One such protection is that if an employee on maternity leave is a member of a pension plan, even if her earnings reduce, her employer must pay contributions to her pension plan using the level of earnings the employee would have been entitled to had she not been on maternity leave[1] for any period of paid maternity leave. The employee herself is only required to contribute as a percentage of what she is actually paid during that time.

For example, Jane earns £500 a week and is a member of a defined contribution pension plan where she makes a contribution equal to 5 percent of her gross earnings per week, and her employer, C Limited, matches her contribution. If Jane goes on maternity leave for a year, during which time she is entitled to 20 weeks' full pay, 20 weeks' half pay, and any remaining period of maternity leave (up to a maximum of 12 weeks) unpaid, the following will apply to her pension contributions:

- Before Jane went on maternity leave, she would contribute £25 to the pension plan each week, and C Limited would contribute £25 to the plan each week.

- During her 20 weeks of fully-paid maternity leave, Jane would contribute £25 to the plan each week, and C Limited would contribute £25 to the plan.

- During her 20 weeks of half-paid maternity leave, Jane would contribute £12.50 to the plan each week, but C Limited would contribute £25 to the plan, as C Limited's contributions are five percent of what Jane's earnings would have been had she not been on maternity leave.

- During her 12 weeks of unpaid maternity leave, Jane contributes nothing to the plan. C Limited is not required to contribute to the plan.

The position would become more difficult if Jane were not a member of the pension plan before she goes on maternity leave and C Limited "stages" during her maternity leave period, as Jane's categorisation could be affected by whether the "staging date" occurs during her paid or unpaid maternity leave period. If this is relevant to you, we recommend that you seek legal advice on the scope of your duties.

What are the implications of salary exchange / salary sacrifice for contributions made to a pension plan used for auto-enrolment?

"Salary exchange" or "salary sacrifice" is the process by which an employee amends his terms and conditions of employment so as to give up the right to receive a portion of his salary in return for his employer making a contribution to (in this case) a pension plan. The employer's contribution is equal to the value of the salary the employee "exchanged" or "sacrificed".

Under the new regime, the law prescribes the minimum *employer* contribution to be made to the plan, and the minimum *total* contribution (i.e. employer plus worker) contribution for eligible jobholders and non-eligible jobholders. There is no minimum worker contribution, and so the employer can choose to contribute all of the total minimum contribution with the result that the worker is not required to make any contributions. If the employer elects to make only the minimum employer contribution, the worker must pay the balance to satisfy the total minimum contribution.

"Salary exchange" or "salary sacrifice" can be used by a worker to make any contributions he is required to make, or chooses to make, to the pension plan, and this results in a National Insurance contributions saving for both the employer and the worker on the value of earnings sacrificed.

TPR guidance states that salary exchange or salary sacrifice must be presented as an option to workers, rather than a requirement.

What is the position for employees ordinarily based in the UK but who are currently working overseas?

Legislation requires that workers who are "ordinarily based in Great Britain", even if they are currently working overseas, are included in the scope of duties owed by employers. For example, an eligible jobholder who is ordinarily based in England but who is working overseas for six months would be caught by auto-enrolment obligations.

However, in our experience, if the employer is using a personal pension plan for auto-enrolment purposes, the plan provider may be unwilling to allow a worker who is not UK resident on the date the employee is auto-enrolled to participate. This leaves the employer in the difficult situation of being obliged to automatically enrol the employee concerned, but not being permitted to do so by the plan provider.

In these situations, the employer should be able to use plan designated as the default plan by the UK government, operated by the National Employment Savings Trust (NEST).

Do pension provisions in contracts of employment require amendment?

In light of the employer duties introduced by the auto-enrolment regime, we recommend that all our clients review the contracts of employment in place with their existing employees, as well as their template contracts. The existing contractual provisions may not work with the employer's plan design for the next few years of increasing minimum contribution levels (rising to a required total contribution of eight percent in October 2018).

Many contracts of employment simply refer to pension arrangements described in a pensions policy, as amended from time to time, and so may appear to allow the employer to change the pension arrangements easily.

Any lessening of the employer's pension obligations set out in employees' contracts of employment will require employee consent (express or implied), and the implementation of the employer duties under the automatic enrolment regime may provide an opportunity to seek that consent.

When worker contribution levels increase, will consultation be required?

UK legislation provides that, for employers with 50 or more employees, certain changes to pension arrangements may only be made after a consultation with affected employees (or their representatives) has been conducted for at least 60 days.

As mentioned above, the contributions required to be made to a qualifying pension plan for auto-enrolment purposes are increasing, firstly in October 2017, and then again in October 2018. Both the employer and the total minimum contributions are increasing, as set out in the table below.

Date	Minimum Employer Contribution	Minimum Total Contribution
"Staging date" to 30 September 2017	1%	2%
1 October 2017 to 30 September 2018	2%	5%
1 October 2018 onwards	3%	8%

Notably, contributions are only required to be made in respect of a band of the individual's "qualifying earnings". The description of "qualifying earnings" in the legislation is very wide, and includes salary, wages, bonuses, commission, overtime and statutory maternity pay. The band may be adjusted each tax year, and is currently £5,772 to £41,865, for the 2014/2015 tax year.

Some employers may choose to provide more than the legal minimum and use "whole earnings" rather than the "band" of earnings defined by legislation. If this applies to the worker's contributions as well as to the employer's, it is possible that legislation could require the employer to carry out 60 days of consultation before increasing the required level of contribution from the employee.

Hopefully guidance will be provided by TPR on this question in advance of the legally-required contribution levels increasing.

If an employer only uses banded earnings to calculate employee contributions, consultation will not be required.

How should I treat independent contractors?

The employer duties under the auto-enrolment legislation (the Pensions Act 2008 and subsidiary legislation) do not apply to people who are truly independent contractors. Therefore, an organisation has no obligation to assess, enrol or pay pension contributions in respect of its independent contractors.

Of course, whether a particular individual is an "employee" (to whom employer duties apply), a "non-employee worker" (to whom employer duties apply) or an "independent contractor" (to whom employer duties do not apply) is a question of fact, and is not determined solely by the terms of the relevant written contract.

Factors used to determine an individual's status include:

- "Is the individual obliged to perform the services personally?"
- "Is the individual under the direction and control of the putative employer?"
- "Is the individual providing their services as part of their own business undertaking?"

The employer duties in the auto-enrolment regime have not yet been tested before the employment tribunals or courts, so we have no judicial guidance as to whether the concept of "worker" in the auto-enrolment legislation should be regarded as the same "worker" concept with which UK employment lawyers are familiar.

However, the drafting of the legislative provisions are virtually identical, and so it is reasonable to suppose that, were an organisation to appeal the imposition of a penalty by TPR to the Upper Tribunal, the Upper Tribunal will draw on the body of employment case law.

Conclusion

The employer duties under the automatic enrolment regime can create stumbling blocks for the unwary. We hope that TPR will produce further guidance on these issues in the future. In the meantime, employers should take comfort that TPR's enforcement approach, as illustrated by the publication of its first report in this area, is focused on working collaboratively with employers with a view to rectifying non-compliance, rather than immediately seeking to punish.

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Endnotes

[1] The nature of the protection is slightly different for employees participating in a defined benefit pension plan – then the benefit the employee accrues must be the same benefit that she would have accrued had she not been on maternity leave.