AUTO ENROLMENT AND NEST

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Almost every employer is now required to auto-enrol employees into some kind of pension scheme. They can either provide their own **company scheme**, or use the **national scheme, NEST**. Employees still must decide where the funds are best invested, and our Research Note on Risk and Asset Allocation provides the starting point for these decisions.

It is unlikely that the **minimum** auto-enrolment contribution rates will, on their own, be sufficient to provide a reasonable level of income in retirement. You should therefore also look at whether you could and should make **additional** savings to supplement any auto-enrolled scheme.

This note takes a detailed look at the auto-enrolment rules and NEST investment options.

SUMMARY

Auto-Enrolment into pensions became effective from 1 October 2012, and aims to combat the pensions funding gap. Since then, almost every employer has been required to administer the auto-enrolment of their employees into either their own pension scheme, or the National Employment Savings Trust (NEST).

Opting out of auto-enrolment is possible, and the decision should be made as for any other pension contribution decision, for example considering the personal circumstances of the individual, the level of employer funding available, fund choice, charges, and any other alternatives available.

Previously, individuals with Enhanced or Fixed Protection from the Lifetime Allowance needed to take particular care to opt-out of any auto-enrolment within one month to prevent loss of protection. However, since April 2023 they have been able to make contributions without losing protection (provided the protection application was made prior to 15 March 2023), and so may wish to consider rejoining.

It is unlikely that the amounts contributed under auto-enrolment will constitute sufficient stand-alone pension planning for most people, and additional contributions to the company or a personal pension scheme should be considered where budgets allow. The responsibility to ensure that sufficient provision is made remains with the individual.

AUTO-ENROLMENT: THE BASICS

WHO?

Employers have to automatically enrol workers who fulfil all the criteria below:

- Are not already in a qualifying workplace pension scheme.
- Are at least 22 years old (a reduction to 18 years old is under consideration).
- Are below state pension age.
- Earn more than the minimum threshold (currently £10,000 a year)
- Work or ordinarily work in the UK (under their contract).

However, even if an individual does not qualify to be automatically enrolled, they still have the right to join the scheme. If they tell their employer that they would like to opt into the scheme, the employer must allow them to do so.

If an employee wishes to opt-out of auto-enrolment, they must do so within one calendar month of joining. In this case, the joining date generally means the later of when active membership starts, and when the enrolment pack is received. Any payments made during this opt-out period will be refunded to the employee. After the month opt-out period, any request to cease membership will be treated as leaving the scheme, and no refunds will be paid.

WHEN?

There is a maximum three month waiting period before your employer must enrol the employee; however, employees aged between 16 and 75 years who want to start saving straight away can opt into the scheme.

INTO WHAT?

The employer must provide access to an auto-enrolment scheme which meets the below criteria on minimum payments. The scheme must have a default fund choice for contributions, where a choice is not specified by the employee.

Existing or new company pension schemes can be used where they meet these criteria, or the employer can offer savings through NEST as detailed below. A combination of schemes can be used to meet the needs of different parts of the workforce.

AUTO-ENROLMENT: THE BASICS

HOW MUCH?

Qualifying Earnings Basis

This is the basis which many employers use to calculate contributions. There is a minimum contribution of 8% of a band of earnings (currently £6,240 to £50,270), including any bonus or overtime which falls within this band. Of this, the employer must contribute at least 3%, and the employee must contribute the balance.

Pensionable Earnings Basis

Pensionable earnings are the higher of:

- The employer's definition of pensionable earnings.
- Basic pay (excludes any variable components such as bonuses, commission and overtime).

This definition includes all earnings from £1 upwards rather than a band.

An employer can only choose to use the pensionable earnings basis if they are certified as satisfying the minimum contribution requirements outlined in the table below. If, for example, the employer wishes to segregate different parts of the workforce, this certificate can cover part of the workforce, with the other part being covered by an auto-enrolment scheme using the qualifying earnings basis.

Minimum Contribution	Set 1	Set 2	Set 3
Minimum total contribution	9% of pensionable earnings	8% of pensionable earnings	7% of pensionable earnings
Including minimum employer contribution of	4%	3%	3%
Reference to total earnings?	Pensionable earnings must be at least equal to basic pay	Pensionable earnings must be at least 85% of total pay	Pensionable earnings must equal 100% of total pay

NATIONAL EMPLOYMENT SAVINGS TRUST (NEST)

NEST is one of the options available to employers in meeting the auto-enrolment requirements. NEST is required to provide a scheme for any employer requesting this, and so will likely be the default choice for many employers, especially smaller employers or where there is no existing company pension scheme.

NEST FUND CHOICES

The default fund is a Retirement Date (a “lifestyling”) fund targeting the specific year of retirement of the member, and moves through three stages:

1. For younger joiners in their 20s, up to five years will be spent in the ‘Foundation’ phase where the main priority is growth tempered by low capital risk (NEST research apparently shows that younger savers may be put off saving if they see even short term falls in value).
2. Then the ‘Growth’ phase aims for inflation + 3% growth ...
3. ... until the ‘Consolidation’ phase around 10 years pre-retirement, where the assets gradually start to be moved into the asset classes that will be used at retirement.

Mechanical lifestyling will not be used, and the NEST investment team will take judgement calls on when is appropriate to move between income and growth phases. The scheme member can switch into whichever Retirement Date year fund they feel is appropriate for their circumstances.

In addition, there are five other fund choices:

- Higher Risk (with a switch into the appropriate Retirement Date fund 10 years before retirement if required).
- Lower Growth (currently cash or near cash).
- Ethical (also using the same Foundation, Growth and Consolidation phase approach)
- Sharia
- Guided Retirement (for investors age 60-70 who wish to start withdrawals but not purchase an annuity until age 85)

Further information can be viewed on the NEST website.

NEST CHARGES AND LIMITS

Charges are 0.3% annual management charge, and also a 1.8% contribution charge (until NEST has repaid its set-up costs to the Treasury, no specific date for this has been given). There are no other switching or other charges, and, from April 2017, no annual contribution limit (although subject to usual pension contribution limits).

TRANSFERS

Transfers into NEST are allowed for defined contributions scheme transfers, pension credit transfers or early leaver cash transfers. Transfers out of NEST to other pension schemes are allowed for those who have ceased contributions to their account.

Important Information: Our views are based upon our understanding of current legislation in England, unless stated otherwise. Levels and bases of, and reliefs from, taxation are subject to change and their value to you will depend upon your personal circumstances.

Risk Warning: The past is not necessarily a guide to future performance. The value of your investment and the income from it can fall as well as rise and is not guaranteed. You may not get back the full amount invested. This document is provided for information only and does not constitute advice. You should not act on any of the information without seeking professional advice.