GUIDE TO AUTO-ENROLMENT AND NEST

AUTOMATIC ENROLMENT: A QUIET REVOLUTION FOR UK PENSIONS

One of the largest-ever shakeups in the history of UK pensions, automatic enrolment – commonly known as 'auto-enrolment' – was introduced in 2012 to provide wider access to pension savings. A changing demographic backdrop means that, while people in the UK are living longer, they are not saving enough to finance their increasingly long retirement.

Auto-enrolment is designed to provide every worker with the opportunity to amass some savings for their old age, while helping to shift the responsibility away from the state and towards the individual. Employers are now obliged to enrol all their employees in a qualifying workplace pension scheme – unless the individual makes an active decision to opt out.

Automatic enrolment began in October 2012 with a gradual introduction that focused on the UK's largest firms. During the first year of the process, 1.6 million workers were auto-enrolled into a workplace pension. Medium-sized and smaller firms are set to enrol their staff gradually over the coming years so that, by 2018, auto-enrolment will cover all companies with one or more employees.

HOW DOES AUTO-ENROLMENT WORK?

In order to be eligible for auto-enrolment, an individual must live in the UK, must be aged between 22 and state pensionable age, must earn more than £9,440 a year and should not already be signed up to a workplace pension scheme. Those who are working, but aged below 22 or above state-pensionable age, can also choose to join. However, individuals who are self-employed or who are already signed up to a workplace pension scheme will not be enrolled.

A minimum percentage of each worker's "qualifying earnings" has to be paid into their pension pot. Employers have to make contributions too and the government makes a contribution through tax relief. Each individual will pay in a minimum of 0.8% of their qualifying earnings, rising to 4% by 2018. Their employer will pay a minimum of 1% of the employee's qualifying earnings, rising to 3% by 2018. Meanwhile, the UK government will pay 0.2% of the employee's qualifying earnings, rising to 1% by 2018.

The employee will be able to decide the level of investment risk they are willing to take with their pension savings. However, in the absence of an active decision from the individual, the default option will be relatively conservative. The pension provider will impose an annual management charge that will be deducted from the pension pot.

THE RIGHT TO CHOOSE

The employee can choose to opt out of their workplace pension scheme if they have been automatically enrolled. If they decide to opt out within a month of being enrolled, any money they have paid in will be repaid to them. If they opt out later on, any contributions will remain in their pension pot until they retire.

If they continue to be eligible, their employer is obliged to re-enrol them after three years although the employee can then choose to opt out once again. They can also choose to opt back in at any time. During the first full year of auto-enrolment, opt-out rates totalled around 10%.

LOOKING TO THE FUTURE

Before the advent of auto-enrolment, only 46% of UK employees were enrolled in a qualifying workplace pension schemes. Since auto-enrolment was introduced, three million people have started saving into workplace pension schemes. It is estimated that, by 2018, between six and nine million people will have increased the amount they are saving into a pension scheme or will have joined a scheme for the first time.

NATIONAL EMPLOYMENT SAVINGS TRUST: WHAT IS 'NEST'?

The National Employment Savings Trust, known for short as NEST, is a national defined contribution workplace pension scheme established by the UK government to support automatic enrolment.

Specifically designed to meet the needs of low-to-middle wage earners who might have no experience of saving into a pension scheme, NEST is intended to encourage saving for retirement and to increase the availability of pension savings for those who do not have access to a workplace pension scheme.

NEST provides one pension pot per person, ensuring a simple, easy-to-track pension scheme for individuals who might subsequently change their job, become self-employed or stop working altogether.

BUILDING A 'NEST' EGG

The annual contribution limit for each member's pension pot is currently limited to £4,500 for the tax year 2013-14, and this limit is likely to make NEST less attractive to those earning a moderate or high level of income. NEST charges are relatively low, comprising an annual management charge of 0.3% and a charge of 1.8% for each contribution.

NEST members can choose from a total of six funds. The Retirement Date Fund targets the year in which the saver expects to withdraw their money and some 90% of members are expected to opt for this, the default option. However, NEST also offers an Ethical Fund, a Higher Risk Fund, a Lower Growth Fund, a Pre-retirement Fund and a Sharia Fund.

A FLEXIBLE OPTION FOR EMPLOYERS

Any UK company can choose to use NEST to help them to meet their new obligations. NEST is intended to be a flexible solution aimed at helping employers to make sure they comply with the new legislation across their workforce. At present, NEST is available free of charge for any employer who wants to use it.

A company can use NEST as its only workplace pension scheme or can use it alongside another scheme. If NEST is unsuitable for the entire workforce, the employer can choose to use NEST for one group of employees and another pension scheme for employees who fall within a different category.

contact

We hope you found the information in this guide useful and informative. If any of the points are of interest or you would like to discuss your own situation in more detail, please get in touch.

This guide is intended to provide information only and reflects our understanding of legislation at the time of writing. Before you make any decision, we suggest you take professional financial advice.

Produced by Adviser-Hub on behalf of your professional adviser. March 2014.