

Automatic enrolment earnings thresholds review and revision 2012/2013

Government response to the consultation on revision proposals for the automatic enrolment earnings trigger and the qualifying earnings band

March 2012

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Executive summary

A key message to emerge from this consultation is that simplicity is critical to the success of automatic enrolment and that simplicity is best supported by aligning automatic enrolment triggers and thresholds with existing payroll thresholds. Alignment gives employers figures that they are familiar with and can explain. It will help them to understand who they will have to automatically enrol and on what portion of their workers' earnings they will contribute.

The challenges of business planning and the need for certainty about the thresholds in advance was a significant theme in the responses. We recognise the importance of longer term financial planning in helping employers prepare for automatic enrolment. However, automatic enrolment represents a significant shift in the pension landscape for the UK and the flexible annual review of the thresholds has been designed to give scope to react to economic circumstances and savings behaviours when setting the thresholds each year.

The Government recognises the advantages of alignment with the tax and National Insurance contributions thresholds. However, a lock-in to any particular approach may not be suitable or sustainable in the event of any future developments in the structure of tax and National Insurance, changes in expected savings patterns or in economic circumstances, so it is important that flexibility to review the thresholds and triggers for future years is retained.

Some respondents addressed low pay and equality issues and argued in favour of a lower entry point to automatic enrolment. We have reviewed that evidence carefully. The group excluded from automatic enrolment by a higher trigger comprises more women than men. However, those with lower earnings are less likely to benefit from pension saving than other groups. In determining the appropriate level for the automatic enrolment trigger, we have had to weigh the possible adverse impact on women of a higher trigger, which may exclude lower earners from pension saving, against the risk that a lower trigger may also adversely impact women by bringing lower earners into pension saving inappropriately.

The majority of the responses favoured alignment with the PAYE threshold for the automatic enrolment trigger and alignment with the National Insurance contributions lower and upper limits for the qualifying earnings band. We, therefore, propose to lay an Order before Parliament as follows:

- £8,105 for the automatic enrolment earnings trigger;
- £5,564 for the lower limit of the qualifying earnings band;
- £42,475 for the upper limit of the qualifying earnings band.

Introduction

Automatic enrolment into workplace pension saving will go live this year starting with the largest employers. Employers will be obliged to automatically enrol workers who meet age and earnings criteria and pay at least a minimum pension contribution based on a percentage of a band of qualifying earnings.

The qualifying earnings band was set (in 2006/07 earnings terms) in the Pensions Act 2008 at £5,035 to £33,540. The automatic enrolment earnings trigger (the level of earnings from which people are automatically enrolled) was set at £7,475 (in 2011/12 terms) in the Pensions Act 2011.

The Government is required to review these amounts each tax year to decide whether they should be changed. On 15 December 2011, we published a formal consultation on proposals for the automatic enrolment earnings trigger and the qualifying earnings band figures for 2012/13.

We received 32 formal written responses from employer organisations, pension providers, accountants, lawyers, trades unions and consumer organisations. We are grateful to everyone who replied. There were no responses from individuals. A list of organisations that responded to the consultation is at Annex D.

This document presents an analysis of the responses to the consultation, our considerations, the evidence that we have taken into account for this review, and our final proposals. It is a companion report and should be read in conjunction with the consultation paper Automatic enrolment earnings thresholds review and revision 2012/2013 published in December 2011.

This Government response is published alongside The Automatic Enrolment (Earnings Trigger and Qualifying Earnings Band) Order 2012. The Order is subject to the affirmative resolution procedure and will require the approval of both Houses of Parliament before it comes into force.

This document is available on the DWP website at:

[Automatic enrolment earnings thresholds: review and revision 2012/2013](#)

Review of the automatic enrolment earnings trigger

What the consultation said

Automatic enrolment into a workplace pension scheme is designed to target moderate to low earners who are either not saving, or not saving enough, for their retirement. The automatic enrolment earnings trigger is the key factor in determining who will be automatically enrolled.

The *Making Automatic Enrolment Work* (MAEW) Review¹ concluded that very low paid people, in particular people who do not earn enough to pay income tax, should not be automatically enrolled. This was because people on low earnings are less likely to benefit from pension saving and automatically enrolling this group carried a greater risk of bringing them into pension saving inappropriately. It therefore recommended that a trigger should be introduced and should be aligned with the threshold at which people begin to pay income tax.

The impact of this approach is predominately on those people who have earnings at a level that makes the choice of trigger a determinant in whether they are automatically enrolled or not. It is important, therefore, in making such a decision to understand how this group is constituted and to understand any equalities implications.

In proposing thresholds for 2012/13, we examined the factors prescribed in the Pension Act 2011 to determine which are relevant to the trigger and which are not. We then looked to strike an appropriate balance between maximising pension saving for those for whom saving is likely to be of benefit and, just as important, minimising the number automatically enrolled for whom it may not be.

We presented three factors in the consultation that we considered most relevant to the review of the automatic enrolment trigger:

- PAYE threshold because this excludes very low earners who do not earn enough to pay tax;
- National Insurance contributions primary threshold because this is the starting point for paid contributions for the basic state pension;

¹ *Making Automatic Enrolment Work* A review for the Department of Work and Pensions Paul Johnson, Frontier Economics and Institute for Fiscal Studies et al; October 2010

- Consumer Price Index (CPI) because price inflation links to the real value of pension savings and affordability.

Consultation question

We asked whether there are other relevant factors that should be taken into account for the revision of the automatic enrolment earnings trigger for 2012/2013 and if so why.

Responses to the consultation

Three-quarters of respondents supported the proposal to align the earnings trigger with the PAYE threshold at 2012/13 values. Others strongly opposed any rise, especially if they perceived it as an interim step towards a higher trigger of £10,000. Others wanted to keep the flexibility to enable future reviews to react to changing economic circumstances. Others wanted to align the trigger with a lower National Insurance contributions threshold rather than the personal tax threshold.

Responses urged caution about indexing automatic enrolment thresholds to earnings – and particularly the earnings trigger – as the low paid tend to get smaller increases in pay in comparison with the higher paid. Responses were largely silent about the relevance of price inflation to the trigger.

The concept of providing a de-minimis level of pension contributions – via a gap between the automatic enrolment trigger and the earnings level from which contributions are collected – remains a popular practical measure. Respondents said that this, combined with the introduction of the optional waiting period, reduces the chance that people will have to be automatically enrolled because of an isolated pay spike only to then make very small contributions.

Some respondents from the financial services sector questioned the need for any thresholds at all as means of encouraging greater saving.

A significant number of responses said that simplicity, coverage and certainty are key to making automatic enrolment work. The headline message was that simplicity is best achieved by alignment with existing thresholds operated by employers. Alignment with the PAYE threshold was generally seen as the most relevant factor for the trigger because it ensures that only workers who will benefit from tax relief are automatically enrolled and it simplifies the assessment of jobholder status, especially for workers with volatile earnings.

Alignment would also ensure triggers were set at levels that employers are familiar with and can explain, and will help them to understand who they will have to automatically enrol and how much to contribute. The tax threshold is already an integral part of payroll systems and would minimise the complexity of adapting payroll systems for automatic enrolment.

Equality issues, particularly the impact of higher thresholds on low paid workers – the majority of whom are women – were the main focus of responses from national organisations representing consumer interests.

Consumer organisations argued that while an element of alignment with existing payroll thresholds may be helpful, particularly to widen the savings band, the automatic enrolment earnings trigger should be de-coupled from the income tax threshold. They proposed alignment of the trigger with the primary threshold for National Insurance contributions or freezing the entry point for automatic enrolment at the level envisaged by the Pensions Commission.

The challenges of business planning and the need for certainty was a significant theme in the responses. Some looked for a clear picture of how the thresholds are likely to be increased in the future to facilitate longer term financial planning and help employers prepare for automatic enrolment.

However, an annual review of the thresholds was welcomed by the small business and accountancy sectors because of the increased scope to react to economic circumstances and savings behaviours. They warned that a long term commitment to alignment with tax and National Insurance contributions thresholds may not be sustainable because of future developments such as the possible restructuring or merger of tax and National Insurance or unexpected opt out patterns.

Government response

There is a considerable degree of synergy between the policy principles proposed in the consultation document and the factors that the majority of respondents thought should drive the level at which the earnings trigger is set. The critical question is the weighting and ranking of those factors in determining which should be the primary driver for the trigger.

The earnings trigger was introduced to help ensure that automatic enrolment brings those people in to pension saving who are most likely to benefit from saving and to ensure that these people pay contributions on a meaningful portion of their income. It is also important to ensure that the administration should be as simple as possible. Both the MAEW Review and the responses to the consultation supported this approach.

We have paid particular attention to respondents who have addressed equality issues in relation to the trigger – many of whom argued in favour of a lower entry point to automatic enrolment – and have reviewed the evidence carefully.

The group that is excluded from automatic enrolment through the introduction of a higher trigger is made up of more women than men. We have weighed the possible adverse impact of a higher trigger on women who might otherwise benefit from pension saving against the risk that automatic enrolment at a lower trigger may bring

some women into pension saving who would not benefit from postponing consumption from a period of low earnings to their retirement. The state pension system will provide a comparatively high proportion of earnings as an income in retirement for the majority of those whose earnings remain low throughout their working life. The credited contribution and lifetime contribution reforms introduced through the Pensions Act 2007 are designed to improve state pension outcomes for people with fragmented working lives and caring responsibilities.

Diverting money out of wages into pension saving at a point when this income is likely to form a critical element of family finances is not likely to be the right choice for the lowest earners. Previous research into women's financial priorities² tells us that family commitments take precedent during periods of low earnings.

Low earners who do want to benefit from saving into a pension will be able to opt in and will receive an employer contribution where they have earnings above the bottom of the qualifying earnings band. It will be important to monitor information about opt in as well as opt out rates among those on low wages as it becomes available so that it can be used to inform future reviews of the trigger and the qualifying earning band.

Nevertheless, we agree with those respondents who said that the National Insurance contributions thresholds are relevant factors to consider when reviewing the value of the trigger.

In assessing the options for 2012/13 we therefore considered the effect of aligning the trigger with the National Insurance contributions lower limit (the LEL) at £5,564; the primary threshold (£7,605) and the PAYE threshold (£8,105). We also considered, but rejected, the prevailing annual rate of the basic state pension as a separate factor to review the entry point for private pension saving because the prevailing rate is very similar to the National Insurance LEL and the considerations and issues are very similar.

Alignment with either of the National Insurance contributions thresholds would bring people who are building state pension entitlement into private pension saving. But we do not believe that setting the entry point for automatic enrolment this low is right for a significant proportion of low earners and it would bring people into pension saving who will not necessarily get tax relief on workplace pension contributions. Aligning the trigger with the primary threshold would also reduce the de-minimis level of

² *Women and Pensions: the evidence*. Department for Work and Pensions Report 2005

Financial plans for retirement: women's perspectives, W Sykes et al., Department for Work and Pensions Research Report No. 247, 2005. However the Sykes samples excluded women in households from the lowest income quintile for whom lack of disposable income would tend to override all other considerations in determining their pension status.

earnings on which contributions would be made to £500 – reducing its usefulness in avoiding very small levels of minimum contributions. A trigger aligned with the LEL would strip the capacity for a de-minimis out of the system altogether.

We note the views of the small business sector, trades unions and pension providers who set out the different effect of earnings inflation on different levels of earnings. We accept that increasing the trigger by earnings inflation may exclude some people whose earnings do not keep pace with the increase. We need to be mindful, however, of the fact that attempting to revalue the amounts in the 2008 or 2011 Pension Acts by the increase in average earnings would introduce an arbitrary threshold into the payroll system.

We noted the calls for certainty and we understand the business planning arguments in favour of committing to a longer term approach. However, the Pensions Act 2011 requires annual reviews of the automatic enrolment thresholds. The Government has indicated its preferred direction of travel by accepting the MAEW Review's recommendation that the thresholds should be aligned with existing recognisable rates used in payroll wherever possible, but cannot anticipate the outcomes of future reviews.

Having considered the consultation response, and weighed all the relevant factors we have concluded, on balance, that the most relevant review factor for the revaluation of the automatic enrolment earnings trigger is the PAYE threshold .

Review of the qualifying earnings band

What the consultation said

The qualifying earnings band drives the minimum amount that people save. Once someone is automatically enrolled and full contribution levels are reached, minimum pension contributions of 8 per cent of a band of earnings are payable with at least 3 per cent from an employer contribution.

When the band of earnings was introduced in the Pensions Act 2008, the lower limit was set at £5,035, aligned with the primary threshold (PT) for National Insurance contributions. This is the level at which individuals begin to pay National Insurance contributions for the basic state pension. The higher level was set at £33,540, aligned with the National Insurance contributions upper earnings limit (UEL).

In 2010, the MAEW Review recommended that the lower limit of the qualifying earnings band should continue to be aligned with the National Insurance contributions primary threshold. It recommended that the upper limit of the qualifying earnings band should be increased in line with the rise in average earnings. At the time, the Government accepted these recommendations.

However, in developing the rates for 2012/2013, we proposed aligning the lower limit of the qualifying earnings band with the National Insurance contributions lower earnings limit rather than the primary threshold to extend the band of earnings, maximise pension saving and provide for an effective de-minimis level of contributions. We proposed to retain a link with earnings inflation for the upper limit to cap employer costs.

We set out four factors that we considered relevant to the review of the qualifying lower limit earnings band:

National Insurance contributions lower earnings limit (LEL) because that is currently the starting point for state pension accruals (on credited contributions);

- National Insurance contributions primary threshold (PT) because that is the starting point for paid contributions for basic state pension;
- price inflation – we used CPI as the relevant measure for consistency with the Government's wider policy because prices are relevant to affordability and employer costs;

- earnings inflation because the Pensions Commission recommended that income in retirement should reflect earnings during working life and as a logical corollary, that pension saving should increase as earnings rise.

And three factors relevant to the upper limit:

- National Insurance contributions upper earnings limit (UEL) because that is the top of the band of earnings for National Insurance contributions (and hence basic state pension accruals);
- price inflation - we have used CPI as the relevant measure for consistency with the Government's wider policy because prices are relevant to affordability and employer costs;
- earnings inflation because the Pensions Commission recommended that income in retirement should reflect earnings during working life and as a logical corollary, that pension saving should increase as earnings rise.

Consultation questions

We asked if there are any other relevant factors that should be taken into account for the revision of the qualifying earnings band lower and upper limits for 2012/13 and if so why.

We asked in particular whether for next year the upper limit of the qualifying earnings band should be capped below the National Insurance contributions upper earnings limit.

Responses to the consultation on the qualifying earnings band

Lower limit

The strongest call overall was to make the band of earnings on which contributions are calculated as wide as possible to increase savings and maintain the differential between the lower limit and the automatic enrolment trigger. The majority of responses supported alignment of the bottom of the band with the National Insurance contributions LEL (also the entry point for state pensions accrual) rather than the primary threshold to ensure that contributions are paid on a reasonably significant element of salary. Respondents felt that this would produce a modest increase on the original 2006/07 level and would still enable more people to save as a result of automatic enrolment. They felt any rise above this would undermine pension savings for low and middle earners given that workers are typically currently seeing very low levels of pay increases.

Alignment with the LEL was not universally welcomed. Some felt that the proposed LEL threshold is too low a level to start collecting automatic enrolment contributions. A very small minority opposed the idea of a contribution band at all and some felt that any increase on the Pensions Commission's original propositions would reduce savings. Some respondents felt that replacement rates should be a relevant factor in determining the contribution band. Trades union responses proposed that opt in should be available with employer contributions and tax relief from pound one of earnings.

Responses from accountants felt that it is important to factor in employee costs as well as employer costs. They supported alignment of the bottom of the band with the National Insurance contributions primary threshold, in conjunction with the introduction of a higher trigger, to lessen the impact of automatic enrolment on those who will be automatically enrolled but have relatively low earnings.

There was also support for the concept and value of the de-minimis gap between the bottom of the earnings band and the automatic enrolment trigger. Some respondents suggested that when reviewing the thresholds in future years, the Government should set a desirable de-minimis before options for thresholds were considered.

Upper limit

Very few respondents supported the proposal to link the upper limit of the qualifying earnings band to earnings inflation because it would insert a new non-aligned threshold into payroll systems and make automatic enrolment harder to explain. There were some concerns that non-alignment at the upper limit could lead to a shrinking of the contribution band over time.

Those who did support an earnings link, at least for the first year of live running, did so because they thought that the system needs to be fair to employers by avoiding additional increases in the cost of employer contributions and that using the proposed re-valued upper earnings figure of £39,853 would achieve this. The small business sector was among those who supported an upper limit capped short of the National Insurance contributions upper earnings limit (UEL), at least for the first year as a temporary measure given the economic climate, but rounded to £40,000 for simplicity.

The majority of responses supported alignment of the upper limit of the qualifying earnings band with the National Insurance contributions UEL. Employers and workers would both have a greater likelihood of understanding how the upper band threshold is arrived at, making automatic enrolment easier to explain. Such an alignment minimises changes for payroll providers and employers by not having to introduce a further threshold within the system. Those respondents who opposed the concept of thresholds or contributions caps at all said if there has to be an upper limit then it should be aligned with the National Insurance contributions UEL to maintain the link with the proportion of salary that is subject to National Insurance

contributions. The widening of the savings band up to the National Insurance contributions upper earnings limit was seen as a way to deliver better long term saving outcomes for individuals.

Pension providers and financial advisors expressed concerns that the minimum contribution levels are unlikely to be sufficient to provide a worthwhile retirement income on their own and thought that choosing an upper limit below the UEL could give the message that a lower level of pension saving is sufficient.

One respondent suggested a compromise approach of using the National Insurance contributions Upper Accruals Point as a factor in determining the value of the upper earnings limit to enable alignment with an existing threshold without going as far as the National Insurance contributions UEL.

Pension providers, financial advisors, payroll solutions companies and the accountancy sectors suggested that the analysis of costings we had set out³ overstated employer costs for 2012/13, because of the incremental implementation of the reforms. Minimum employer contributions in 2012/13 will only be 1 per cent of qualifying earnings and the impact of the different levels of earnings bands would not affect small and medium-sized companies because the duty to automatically enrol would not apply to them 2012/13.

They also suggested that people with earnings around the National Insurance contributions UEL of £42,475 are likely to be in a company pension scheme already (or with an employer that will use certification) and alignment at the top end with the National Insurance contributions UEL affects only earners in the top quintile. Pension schemes for people at this level are likely to have a higher definition of pensionable pay and unlikely to have a cap. They suggested many employers may already pay more than the automatic enrolment minimum into pensions for such workers and that, where costs did increase, most businesses are likely to be relatively comfortable with a small increase to benefit packages for their higher-paid employees.

Government response

We carefully considered which of the factors are relevant to the review of the qualifying earnings band. Some of the factors are not relevant to the lower limit of the qualifying earnings band because they are clearly intended as factors relevant to the upper cap on the earnings band. Similarly, some factors are not relevant to the upper limit of the band. A detailed analysis of the factors we considered and rejected is in Annex C.

³ Our costings assumed that all employers had been brought into the reforms with at least the full eight percent contributions

We then considered how effectively the relevant factors delivered the policy intentions and addressed the needs and concerns of savers, employers and the pensions industry.

The National Insurance contributions primary threshold increases substantially between 2010/11 and 2012/13. If the lower limit of the qualifying earnings band was set at £7,605 (the primary threshold for the 2012/13 tax year) with an automatic enrolment earnings trigger of £8,105, the effect would be to provide a de-minimis of £500 of qualifying earnings. Even at the full eight per cent contribution rate, this leads to minimum contributions of only 77p per week. During the first phasing period, it would mean minimum contributions were as low as 20p per week. This is not consistent with our policy objectives to encourage worthwhile saving and to avoid an administrative effort on behalf of the employer that is disproportionate to the amount of savings generated.

Respondents' criticism of earnings uprating for the qualifying earnings band told us two things: that earnings inflation is not seen as a fair measure because it has a differential impact on different earnings groups; and the £2,600 difference between using earnings revaluation and alignment with the National Insurance contributions UEL to set the upper limit is not as significant an issue for 2012/13 in the light of the staging profile, the phasing in of minimum levels of contributions and the likelihood of existing more generous provision already being in place for higher earners. This suggested that an increase in the upper limit of the qualifying earnings band to the 2012/13 UEL of £42,475 would have a more minimal impact on employer costs in the first year.

Review and revaluation of the top or bottom of the band by earnings inflation, price inflation or the prevailing rate of basic state pension may be relevant in some respects but these factors do not deliver the policy objectives. In particular, it would add complexity by disaligning thresholds from other existing earnings thresholds and triggers.

We do not agree with the proposition that we should abolish all thresholds and require contributions from the first pound of earnings with matching employer contributions on all earnings without a ceiling. This proposal was considered and rejected at an early stage in the development of the automatic enrolment legislation.

The automatic enrolment qualifying earnings band is designed to set minimum pension contributions, not a maximum saving level providing a measure of minimum quality not a mandatory method of calculation. Employers who wish to offer contributions from pound one or matched contributions on higher earnings levels can continue to operate on this basis, provided that the amounts paid are at least equal to the minimum requirements. The Certification provisions may apply to ease administration for employers who wish to calculate contributions on this basis.

It does not follow that non-alignment with the National Insurance contributions upper limit would lead to an erosion of the contribution band over time. Aligning the upper

limit of the qualifying earnings band with the National Insurance contributions (UEL) for 2012/13 does not set a pattern for the future.

Workplace pension saving builds on the foundation of the state pension. Automatic enrolment with an employer contribution at the minimum savings level provides an opportunity to start building pension benefits to supplement state pension income. While we recognise the value in using replacement rates as a factor in setting the general approach for automatic enrolment, workplace based pension saving is just one building block in financial provision for retirement. We expect people to take personal responsibility for saving beyond the minimum provide for by automatic enrolment. The qualifying earnings band sets this minimum quality standard for money purchase schemes.

We agree that the existence of a de-minimis level of contributions is important and this has been taken into account in determining the relevance of each factor and in reaching our conclusion on which of the relevant factors we will take forward.

Qualifying earnings set an automatic enrolment quality requirement for money purchase schemes⁴. We have rejected the Upper Accrual Point (UAP) as a factor because it ceases to exist for money purchase schemes with the abolition of contracting out for these schemes from April 2012.

Having considered the consultation responses, we have concluded that the most relevant review factors for the revaluation of the qualifying earnings band for 2012/13 are the National Insurance contributions lower and upper earnings limits.

⁴ There are separate quality tests in the Pensions Act 2008 for defined benefit and hybrid schemes predicated on defined outcomes rather than qualifying earnings.

Government proposals for 2012/13 automatic enrolment earnings trigger and qualifying earnings band

A draft affirmative Order is being laid before Parliament which specifies the following rates:

- £8,105 for the automatic enrolment earnings trigger;
- £5,564 for the lower limit of the qualifying earnings band;
- £42,475 for the upper limit of the qualifying earnings band.

The Order will be debated in both Houses before it comes into force on the day after the Order is made.

An analysis of the costs and benefits are in Annex A.

The equality implications of changes to the earnings trigger are described in Annex B.

Pay reference periods

The purpose of the automatic enrolment trigger is to enable the employer to determine who is eligible for automatic enrolment or automatic re-enrolment. The qualifying earnings band determines who has jobholder status (assuming age conditions are satisfied) and is therefore entitled to opt in with an employer contribution.

What the consultation said

The Pensions Acts 2008 and 2011 set out automatic enrolment thresholds in annual terms for the purpose of assessing jobholder status. To make this work in practice, employers will need to apply the relevant pro-rata version of the figure appropriate to their payroll cycle.

The consultation set out the pay reference periods we believe are commonly used by employers based on our work and that of The Pensions Regulator with the payroll software industry:

- Weekly
- Fortnightly (2 weeks)
- Calendar monthly
- Lunar monthly (4 weeks)
- Quarterly (3 calendar months)
- Tri-annual (4 calendar months)
- Bi-annual (6 calendar months)

Consultation question

We asked whether the pay periods set out in the consultation paper captured all pay periods employers use.

Responses to the consultation

Two thirds of responses were either silent on pay reference periods or thought the list above captured the patterns they used or were aware of.

Responses from accountants and major payroll providers provided more detail. The list in the consultation paper was thought to be more than comprehensive for regular patterns, omitting only annual pay periods. Respondents said that there is only a need to prescribe pay periods of weekly, 2-weekly, 4-weekly (more accurate than lunar monthly) and monthly pay periods and then to provide calculation and rounding rules for anything else. A triannual payroll (4 calendar months) is rarely used. Some monthly payrolls operate a 4 week / 4 week / 5-week payment pattern.

Responses suggested that non-standard and irregular pay patterns could be dealt with by dividing the relevant annual rate by the number of days in the pay reference period and then rounding to the nearest whole number.

Payments may equate to all sorts of calendar points. Monthly payroll may be coincidentally aligned with a calendar month, but it often refers to the frequency gap between the payments which are not truly aligned with calendar months.

A major payroll provider supported complete alignment with HMRC rules on tax and National Insurance contributions calculations mirroring pay intervals, calculation of contributions and the definition of qualifying earnings and said that the change in automatic enrolment rates should align with the tax common commencement date. A lead organisation for the accountancy profession said that although the definition of earnings components will be different for National Insurance contributions and qualifying earnings, the actual calculations will give rise to the same answer for most workers.

Government response

We propose to prescribe proportionate pay reference periods for:

- one week;
- two weeks;
- four weeks;
- one month;
- three months;
- four months;

- six months.

The definition that we had used for calendar monthly is not intended to imply a definition of the start of a month to the end of a month. It can equally be, for example, mid-month to mid month. The same principle applies to weekly pay reference periods.

An annual pay period is provided because the Order will replace the annual figures in sections 3(1)(c), 5(1)(c) and 13(1) of the Act.

The amounts in the Order will apply for the 2012/13 tax year and come into force the day after the day on which the Order is made for this year. For next year (2013/14) and beyond we intend that the point of change will be 6 April to align with common commencement dates.

It is not possible to cater for irregular earnings patterns in the way suggested with a daily value of the pay reference periods. Regulation 4 of The Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations does not allow for a pay reference period of less than a week.

The regulations have been drafted this way to exclude the possibility of a daily pay reference period because this would oblige an employer to assess jobholder status on a daily basis (assuming that the relevant employment contract formalised the right to daily payments and the employer actually paid daily). The proportionate value of the trigger for a daily pay reference period (iterating that this is neither legally possible nor desirable) would be £23. Such an approach could oblige employers to automatically enrol, for example, a 22 year old student with a Saturday job and a young person aged 16 with, for example, a weekend paper round could have an opt in right. This is not the policy intention.

We do not accept that complete alignment with HMRC rules is the correct approach to defining pensionable pay for automatic enrolment. The definition of qualifying earnings has been developed to take into account the common pay components that make up the pay packet of the majority of workers and covers industries where basic salaries are low but bonuses are a usual part of the remuneration package or commission (on target earnings or OTE) is the norm.

It is not intended that automatic enrolment, a sizeable task for employers and the industry in itself, should require employers and workers to pay into a pension on other allowances and benefits, which are often in place to defray employment expenses. We do not therefore propose to amend the definition of qualifying earnings.

Annex A: Costs and benefits of final proposals

Table 1: Estimates of the impact of changing the earnings trigger and upper and lower limits of the qualifying earnings band on employers, individuals and Government (£ million, in 2012/2013)

	Earnings Trigger	Qualifying Earnings Band – Lower Limit	Qualifying Earnings Band – Upper Limit	Employer Contributions	Individual Contributions	Individual Tax Relief	Level of Pension Saving	Employer Tax Relief
Baseline	£7,692 terms (baseline of PAYE threshold of £7,475 in 2011/12 revalued by average earnings)	£5,983	£39,853	£23m	£18m	£5m	£46m	£6m
Proposal	£8,105 (2012/13 PAYE Personal Tax threshold)	£5,564 (2012/13 Lower Earnings Limit)	£42,475 (2012/13 Upper Earnings Limit)	£24m	£19m	£5m	£48m	£6m

Difference	-	-	-	+£0.9m	+£0.7m	+£0.2m	+£1.9m	+£0.2m
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Notes:

Source: DWP modelling.

Figures are expressed in 2012/13 earnings terms.

Figures are rounded to the nearest £10 million and 100,000 as appropriate.

Pension saving is the sum of tax relief, employer contribution and individual contribution costs

Annex B: Equality implications of changes to the earnings trigger

We estimate that there are 9 to 10 million workers eligible for automatic enrolment, of whom just under two in five (39 per cent) are women.

Raising the 2011/12 value of the automatic enrolment trigger from £5,035 (in 2006/07 terms) to £7,475 excluded 600,000 individuals (78 per cent of whom are women). As women are more likely to work part-time, or earn less than men, they will be disproportionately represented in the group excluded from automatic enrolment by an upward revision of the trigger and conversely in any group brought into pension saving by a decrease in the trigger. For example:

- of the 20,000 individuals brought into pension saving on a trigger of £7,605, around 17,000 are women;
- of the 40,000 individuals who would not be eligible for automatic enrolment if the earnings trigger was revised to £7,864 from £7,692 (in 2012/13 terms), around 34,000 are women;
- if the earnings trigger was revised to £8,105, the equivalent figures are around 75,000 women excluded from a total of around 90,000.

Persistent low earners tend to find that the State, through pensions and benefits, provides them with an income in retirement similar to that in working life without the need for additional saving. For these individuals, it may not be beneficial to direct income from working life into pension saving. Furthermore, anyone who is not automatically enrolled because of an increase in the earnings trigger will retain the right to opt in with an employer contribution. Employers will be required to provide information about this.

Revising the current earnings trigger to the PAYE threshold (£8,105 in 2012/13 terms) does not affect the proportion of minority ethnic groups in the total number of persons to be automatically enrolled. The composition of the revised eligible group remains the same at 12 per cent black and minority ethnic groups (BME).

The evidence also suggests that revising the earnings trigger would not particularly affect people with a disability. It is estimated that 17 per cent of the revised eligible group will comprise workers with a disability if the earnings trigger is revised to £7,864 or £8,105 (in 2012/13 terms). This is the same proportion as is included in the current eligible group (£7,684 in 2012/13.)

The median age of those eligible for automatic enrolment on the current earnings trigger is 40 years which indicates that there is a slightly higher proportion of younger workers in the eligible group. However specific age groups are not particularly affected by changing the value of the earnings trigger.

The changes under consideration are not expected to particularly affect individuals according to their sexual orientation, religion or belief.

Annex C: Review factors considered and rejected for the revision of automatic enrolment thresholds

The statutory power to review the automatic enrolment thresholds deliberately provides for a significant degree of flexibility. This allows Government to set appropriate figures for each year and to react to changing priorities and economic circumstances.

The review may take into account the general level of prices, earnings, personal income tax PAYE threshold, and National Insurance contributions thresholds, the prevailing rate of state pensions, and any other relevant factors.

Following our analysis of the consultation responses, we have revisited the review factors and reconsidered our initial proposals. We rejected factors for a range of reasons:

- not relevant to the particular threshold under review;
- relevant but so similar that we consider they should be subsumed by other factors;
- relevant but bring further complexity into the system for the first year of live running;
- relevant but failed to deliver a policy objective.

Policy objectives

Will the right people be brought in to pension saving? In particular, at what level will the earnings trigger bring in as many people as possible who will benefit from saving? At what level does the trigger need to be set to avoid the automatic enrolment of those who are unlikely to benefit from saving? And what are the equality implications of the different options?

What is the appropriate minimum level of saving for people who are automatically enrolled? The size of the band of earnings on which people will accrue their pension contributions will determine the minimum amount that they will save and how much their employer will contribute to their pension. The MAEW review

recommended that everyone who is automatically enrolled should pay contributions on a meaningful portion of their income. To ensure this, we need to maintain a gap or de minimis between the lower limit of the qualifying earnings band and the earnings trigger so that no one is automatically enrolled and then only pays contributions of a few pence a month.

Are the costs and benefits to individuals and employers appropriately balanced? This was one of the key questions investigated through the MAEW Review and it remains relevant, particularly in the light of current economic circumstances. In particular, we have considered the MAEW recommendation that automatic enrolment figures should be aligned with tax or National Insurance contributions thresholds which are already familiar to employers.

Automatic enrolment earnings trigger

The National Insurance contributions upper earnings limit is not a relevant factor for the trigger because it is too high. It serves as a cap rather than an entry point.

The values of the National Insurance contributions LEL and primary thresholds in 2012/13, although relevant in principle, were rejected because they would bring people into pension saving who cannot get tax relief on workplace pension contributions.

The rate of the basic state pension (£5,588) was rejected because it is very similar to the level of the National Insurance contributions LEL; it also does not provide the de-minimis cushion.

A “do nothing” option that would freeze the trigger at the 2011/12 rate has also been excluded. It makes no sense for the first year of live running to add an additional non-aligned threshold into payroll.

We originally rejected earnings as an appropriate review factor because, although relevant, earnings revaluation produces a figure that is very similar to the National Insurance contributions thresholds and the impact is similar. The further evidence from the consultation responses shows the importance of alignment. Revaluation by earnings would bring a random figure into payroll processing.

Consultation responses were silent on the relevance of CPI or the rate of basic State Pension. These factors are relevant but do not deliver our policy outcomes for next year, either because the figure does not deliver a de-minimis cushion or it would introduce a random non-aligned threshold into 2012/13 payroll.

A summary of factors that we have considered and rejected for the 2012/13 tax year for the automatic enrolment earnings trigger follows at Table 1

Table 2: Review factors considered and rejected for the revaluation of the automatic enrolment earnings trigger

Value 2012/13	Factor	Reason excluded
£42,475	NICs UEL	Too high to be an entry point for saving.
£5,564	NICs LEL	Not tax-relievable at the lower end De-minimis not achieved at this figure
£5,588 (rounded)	Rate of basic state pension in payment	Not tax-relievable at the lower end De-minimis not achieved at this figure Too complex; introduces a random non-aligned threshold into 2012/13 payroll.
£7,475	Frozen at 2011/12 PAYE threshold	Too complex; introduces a random non-aligned threshold into 2012/13 payroll.
£7,605	NICs PT	Not tax-relievable at the lower end Reduces de-minimis figure.
£7,692	Earnings	Originally excluded as figure very similar to NICs PT (£7,605) and the impact is similar. Different impact on low, median and high earners. Too complex; introduces a random non-aligned threshold into 2012/13 payroll.
£7,864	CPI	Too complex; introduces a non-aligned threshold into payroll.

Lower limit of the qualifying earnings band

The National Insurance contributions upper earnings limit is not a relevant factor for the qualifying earnings band lower limit. It is too high. It marks the start of lower National Insurance contributions. It is not an entry level for basic saving.

The PAYE threshold is too high for the lower limit of the qualifying earnings band. It shrinks the qualifying earnings band and reduces savings. Such a large increase does not deliver the policy objectives and would be counter to the majority stakeholder view.

We have considered and rejected the National Insurance contributions primary threshold because the link with state pension entitlement starts with the National Insurance contributions LEL and alignment with the primary threshold at £7,605 for 2012/13 would reduce the de-minimis to a nugatory £500.⁵

We have considered and rejected the rate of the basic state pension as a review factor for the lower limit for next year only because at £5,588 it is very close to the National Insurance contributions lower earnings limit of £5,564.

We do not propose to take a “do nothing” option forward to retain the value of the lower limit of the qualifying earnings band at the original £5,035. This was the National Insurance contributions primary threshold in 2006/07 set at prevailing price levels. It does not make sense to retain a figure that does not take account of the current cost of living or economic circumstances. It also increases employer costs.

A summary of factors that we have considered and rejected for the 2012/13 tax year for the lower limit of the qualifying earnings band follows at Table 2.

Table 3: Review factors considered and rejected for the revaluation of the qualifying earnings band lower limit.

Value 2012/13	Factor	Reason excluded
£42,475	NICs UEL	Too high to be an entry point for saving.
£8,105	PAYE threshold	Narrows the savings band Removes the distinction between a jobholder who is eligible for automatic enrolment and a jobholder who may opt in with a right to an employer contribution and makes the opt-

⁵ Assuming the trigger is aligned with the PAYE threshold

Value 2012/13	Factor	Reason excluded
		in right nugatory De-minimis not achieved at this figure
£7,605	NICs PT	Not the primary link with basic state pension entitlement De minimis too small.
£6,055	CPI	Too complex; introduces a random non-aligned threshold into 2012/13 payroll.
£5,983	Earnings inflation	Too complex; introduces a random non-aligned threshold into 2012/13 payroll.
£5,588 (rounded)	Rate of basic state pension in payment	Similar to the NICs LEL (£5,564) Too complex; introduces a random non-aligned threshold into 2012/13 payroll.
£5,035	Frozen at NICs primary threshold 2006/07	Adds cost to business.

Upper limit of the qualifying earnings band

The National Insurance contributions lower earnings limit, the National Insurance contributions primary threshold and the rate of basic state pension are all far too low to be relevant factors. Ranging from £5,564 to £7,605 they point towards entry levels not a cap.

We do not propose to take a “do nothing” option forward to retain the value of the lower limit of the qualifying earnings band at the original £33,540. This was the National Insurance contributions upper earnings limit in 2006/07. Minimum contributions capped at this level would risk individuals under saving and undermine the policy objectives of the reforms.

The response to the consultation has demonstrated that CPI and earnings inflation would introduce an unnecessary level of complexity as non-aligned figures.

A summary of factors that we have considered and rejected for 2012/13 for the qualifying earnings band upper limit follows at Table 3.

Table 4: Review factors considered and rejected for the revaluation of the qualifying earnings band upper limit

Value 2012/13	Factor	Reason excluded
£5,564	NICs LEL	Too low to be relevant to the upper limit of the qualifying earnings band
£5,588 (rounded)	Rate of basic state pension in payment	Too low to be relevant to the upper limit of the qualifying earnings band
£7,605	NICS PT	Too low to be relevant to the upper limit of the qualifying earnings band
£33,540	NICs UEL 2006/07 (Pensions Act 2008)	No-change scenario that constrains minimum savings with too narrow a band of qualifying earnings Too complex; introduces a random non-aligned threshold into 2012/13 payroll.
£39,853	Earnings inflation	Too complex; introduces a random non-aligned threshold into 2012/13 payroll.
£40,040	Upper Accruals point for S2P; NI ceiling for contracted out schemes	Will not exist after 2012 for money purchase schemes with the abolition of contracting out.
£40,475	CPI	Similar to NICs UEL for the larger employers going live in 2012/13 Too complex; introduces a random non-aligned threshold into 2012/13 payroll.

Annex D: Respondents

ABI

Association of Consulting Actuaries

Age UK

Alexander Forbes Financial Services

AON

Aviva

BC&E

Birmingham City Council

Capita Hartshead

Ceridian

Chartered Institute of Payroll Professionals

Chartered Institute of Personnel and Development

FSB

Hargreaves Lansdown

ICEAW

Institute and Faculty of Actuaries

JLT Benefit Solutions Ltd

Legal & General

Mercer

NAPF

Payroll Alliance

Pensions Management Institute

Prudential

Scottish Life

Scottish Widows

Society of Pension Consultants

Standard Life

The Learn Centre

Towers Watson

TUC

Which?

Wragge & Co

Annex E: Glossary of terms

Automatic enrolment Employers will be required to make arrangements by which eligible jobholders become active members of an automatic enrolment scheme with effect from the automatic enrolment date.

Automatic enrolment earnings trigger Prescribed level of earnings required for an individual to be automatically enrolled into their employer's workplace pension scheme.

Consumer Price Index (CPI) measures consumer inflation with reference to the changing cost of a fixed basket of goods and services.

Eligible group: The 9 to 10 million workers eligible for automatic enrolment.

Lower Earnings Limit (LEL) is the point at which employees start to build up entitlement to contributory benefits. It is fixed each year by regulations.

National Insurance contributions primary threshold (PT) is the earnings level from which payment of National Insurance Contributions (NICs) is due. It is fixed each year by regulations.

National Insurance contributions upper earnings limit (UEL) Where earnings exceed the UEL the employee pays National Insurance contributions at 2per cent on those earnings above the UEL.

Pay As You Earn (PAYE) is a tax collection system operated by employers who calculate and report deductions from earnings above a PAYE personal allowance threshold using tax codes and rules provided by HMRC.

Pensionable pay Pay on which pension contributions are calculated.

Qualifying earnings An earnings band comprised of salary, wages, commission, bonuses, overtime, statutory sickness, maternity, paternity and adoption pay. Contributions into a money purchase scheme must at least equal a minimum of 8per cent (of which at least 3per cent must be from the employer).

