



## AUTO ENROLMENT AND THE EMPLOYER DUTIES – QUALIFYING EARNINGS FACTSHEET

The minimum contribution quality requirement for an auto enrolment scheme is based on a band of earnings called qualifying earnings (QEs). This factsheet will tell you what you'll need to know about QEs. It will also explore some of the areas you should consider if a client is thinking of using QEs for their pension scheme.

We've based this factsheet on our current understanding of the relevant legislation and regulations, which might change in the future.

### WHAT ARE QEs?

QEs are a band of earnings of more than £5,876 and £45,000 or less. These are the figures for 2017/18 and they're expected to change each year.

#### QEs in practice – A basic example



**Employer A provides a car allowance to workers based on their grade.**

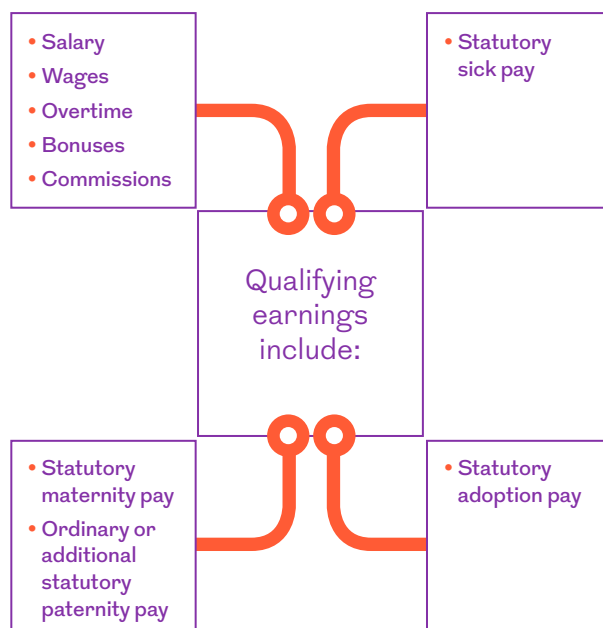
This benefit is included in the contract of employment as part of workers' salaries. For that reason, the allowance must be included in QEs.



**Employer B provides a car allowance to workers who have to travel extensively as part of their role.**

As this is a business expense rather than part of the benefits package, it's not included in the contract of employment. For that reason, the allowance won't be included in QEs.

The diagram below shows the components of pay that must be included in QEs. What the employer includes within the definition of salary and wages will depend on the contracts of employment they have in place and it could differ from employer to employer.



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## CONTRIBUTION LEVELS USING QEs

The minimum contribution quality requirement for a scheme using QEs can be phased in from the employer's staging date, as shown in the table below.

Contribution levels required to meet the contribution quality requirement as a percentage of qualifying earnings			
Date	Total must be at least	Employer must contribute	Agreement must be in place for jobholder to make up at least any difference between the total and the employer amount.
Employer's staging date to 5 April 2018	2%	1%	
6 April 2018 to 5 April 2019	5%	2%	
6 April 2019 onwards	8%	3%	

Source: [www.thepensionsregulator.gov.uk/employers/contributions-funding-tax](http://www.thepensionsregulator.gov.uk/employers/contributions-funding-tax).

## BACKGROUND TO THE MINIMUM CONTRIBUTION QUALITY REQUIREMENT

When deciding on the minimum contribution quality requirement for auto enrolment, The Pensions Commission<sup>1</sup> set a replacement rate of 45% of pre-retirement income at State pension age after 40 years of saving.

They estimated that 30% of the replacement income would come from State benefits and the remaining 15% would come from private pension saving under auto enrolment. To reach this level they estimated that an average earner would need to save around 8% of their earnings for around 40 years.

<sup>1</sup> Source: Making automatic enrolment work – A review for the Department of Work and Pensions, October 2010.

## CONSIDERATIONS FOR EMPLOYERS

If an employer is thinking about using QEs with their auto enrolment scheme, there are a lot of things they need to consider and they'll need your help to make sure they understand the implications.

### The impact of QEs on payroll and administration

- If the employer uses a payroll system it's likely to calculate pension contributions on basic or total pay. They should check whether their payroll provider will update the system to calculate pension contributions based on 8% of QEs and whether they'll be charged for this.
- They should also check that the payroll provider will update the QEs thresholds in good time when they change. If they are not changed on time, the employer could be making contributions below the minimum contribution quality requirement and could face fines from The Pensions Regulator (TPR).
- Making changes to payroll could take time and the employer will need to ensure that the changes are made before their staging date to avoid fines from TPR.
- If the employer runs a manual payroll process, they'll need to understand all the rules and update their processes to calculate the correct contributions.
- The employer may need to train their payroll staff to make sure they understand the changes and the effect on their processes.



### The impact of QEs on the workforce

- Workers' contributions will be limited as they can only make contributions based on their qualifying earnings. This means the first £5,876 of their earnings as well as anything they earn over £45,000 won't be used to calculate their pension contributions.
- Workers might find the QEs basis more difficult to understand as their pension contributions are based on QEs rather than a percentage of defined salary.
- As a result, the employer could receive more questions from workers about their contributions.
- Workers may object to making pension contributions on any bonus or overtime they earn.
- The employer should put in place an effective communication strategy that educates workers on QEs and what it means for them.

### QEs in practice – A basic example

- Jim earns £64,000
- Jim's qualifying earnings will be:

$$\begin{array}{r} \text{£45,000} - \\ \text{£5,876} \\ \hline = \text{£39,124} \end{array}$$

- The employer will also need to have an ongoing communication strategy in place to inform workers about the changes to their contributions each year when the QEs thresholds change.
- If the employer has fluctuating pay such as overtime, their pension contributions will also fluctuate making it more difficult to budget for their contributions.
- As the employer is only providing the minimum contribution quality requirement it's unlikely that this will be competitive and may have a negative effect on recruitment and retention of staff.



### Using QEs with an existing pension scheme

- The effect on employer and worker contributions will depend on the worker's earnings – some contributions will reduce, others will increase.
- The employer should consider reviewing their contracts of employment and agree any changes required.
- They may need to take legal advice resulting in extra costs.
- Any changes to contracts of employment will need to be made in good time before the staging date.
- Consultation with unions, staff committees and workers may be required to change the basis of the pension scheme. This could be difficult if the changes have a negative impact on workers' pension savings and will take time.
- The employer should put in place an effective communication strategy that educates workers on QEs and the effect of the changes on them.

### Using QEs for a specific category of pension scheme

- If the employer only wants to use QEs for one category within their scheme, the other categories will use certification so the employer will need to be able to identify the workers covered by the certificate.
- The employer will need to be able to deal with the different processes and rules applying to each category.
- They will also need to create different communication strategies for each category to explain to workers how the category works.
- The employer must ensure that there is no discrimination when deciding which members go into different categories for example based on sex, age or disability.
- The employer will need to have a process in place to move workers between categories as their status changes.

### QEs in practice – A basic example

- Tasty Foods Ltd. contributes 2% of basic pay into the pension scheme. Their workers also contribute 2% of basic pay.
- They're thinking of changing their scheme to base contributions on QEs. They will contribute 5% and workers will contribute 3% of QEs.
- The table shows the effect of the change on some of their workers' pension contributions.

Worker	Basic pay	Current employer contributions (monthly)	New employer contributions (monthly)	Increase/decrease	Existing worker contributions (monthly)	New worker contributions (monthly)	Increase/decrease
Adam	£10,000	£16.67	£17.18	Increase	£16.67	£10.31	Decrease
Joyce	£12,000	£20.00	£25.52	Increase	£20.00	£15.31	Decrease
James	£20,000	£33.33	£58.85	Increase	£33.33	£35.31	Increase
Edith	£45,000	£75.00	£163.02	Increase	£75.00	£97.81	Increase
Mary	£75,000	£125.00	£163.02	Increase	£125.00	£97.81	Decrease

### Combining QEs and phasing of contributions

- Where QEs and phasing are combined, there could potentially be two changes to the contribution rates in one year – on the phasing date and 6 April when the QEs thresholds change. The employer will need to ensure that they have a process in place to make changes to contributions.
- They should also ensure they have the right communications in place to inform workers of the changes.
- The total pension contributions will be very low so the employer will need to think about whether they are providing a valuable benefit to their workers.

### HOW ROYAL LONDON CAN HELP

As you can see there is a lot for you and your clients to think about if they are considering using QEs for their pension scheme. We're pension experts and we can help you and your corporate clients prepare for auto enrolment and the employer duties. To find out more speak to your usual Royal London contact or visit the auto enrolment area of our website at [adviser.royallondon.com/autoenrolment](https://adviser.royallondon.com/autoenrolment).

### QEs & phasing in practice – A basic example

- John works for Tasty Foods Ltd. and earns £15,000 each year.
- His employer is thinking of changing the pension scheme to base contributions on QEs.
- This means John's QEs will be limited to £15,000 - £5,876 = £9,124.
- His contributions will be phased in from his joining date to April 2019.
- We have assumed that John's salary and the QEs thresholds don't change.

Date	Contribution rate	Total monthly contributions
John's joining date	2%	£15.21
April 2018	5%	£38.01
April 2019	8%	£60.82



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