

AUTOMATIC ENROLMENT FACT SHEET 5:

USING SALARY EXCHANGE WITH AUTOMATIC ENROLMENT

It's important employers fully understand their duties as part of automatic enrolment. To assist with this, Scottish Widows has produced a range of fact sheets covering some of the key technical aspects of the regulations. Further details may be found on the Pension Regulator's website: <http://www.thepensionregulator.gov.uk/employers/tools/employer-duties.aspx>

Salary exchange in conjunction with pension funding is an accepted form of planning that could reduce an employer's costs of complying with their automatic enrolment obligations. However, the workplace pensions legislation imposes certain requirements that an employer must be aware of before setting up a salary exchange arrangement.

SALARY EXCHANGE AND PENSIONS – WHAT IS IT AND WHAT ARE THE BENEFITS?

In return for the employee consenting to a reduction to their salary, the employer contributes to their pension. It's important that the terms of the employee's contract are actually varied, and that both parties consent, for the arrangement to be valid and the savings to apply. This could be achieved by an employer issuing a revised contract that would apply unless any employee 'opted out' of the arrangement – a negative affirmation basis. Once up and running, a salary exchange arrangement will provide some very worthwhile benefits:

- a 13.8% saving in National Insurance Contributions (NIC) for the employer for earnings above the secondary threshold (£8,112 for 2015/2016, £7,956 for 2014/2015)
- a 12% NIC saving for an employee exchanging salary between the primary earnings threshold and the upper earnings limit (£8,060 to £42,385 for 2015/2016, £7,956 to £41,865 for 2014/2015)

- a 2% NIC saving for an employee exchanging salary above the upper earnings limit (£42,385 for 2015/2016, £41,865 for 2014/2015).

These savings can be applied as further pension contributions by the employer and/or employee.

SALARY EXCHANGE – GENERAL CONSIDERATIONS

A salary exchange arrangement may not be appropriate to everyone and will depend on individual circumstances:

- a reduction in salary will impact other salary linked benefits such as benefits payable on death and redundancy payments
- it will also impact on certain state benefits such as maternity pay and working tax credit
- salary should not be sacrificed below the lower earnings limit (£5,824 for 2015/2016, £5,772 for 2014/2015) as this will affect entitlement to state benefits
- earnings must not fall below the National Minimum Wage as a result of salary exchange.

SALARY EXCHANGE AND AUTOMATIC ENROLMENT – SPECIFIC CONSIDERATIONS

The benefits of using salary exchange with pensions continue to be available with automatic enrolment. However, employers need to take account of some specific considerations and may require guidance in setting up and running the two processes together. Not least the fact that one process doesn't require active participation by the individual whereas the other does.

Mustn't be conditional

An employer can't make salary exchange a condition for enrolment into the pension scheme. This means employers will need an alternative joining process for jobholders who don't wish to use salary exchange. The employer may also have jobholders where it has identified that salary exchange wouldn't be appropriate.

Basis for contributions

If the employer is using qualifying earnings as the basis to calculate contributions, a reduction in salary will mean a lower basis on which to base minimum contributions. Alternatively, if contributions are based on pensionable pay, the scheme rules/governing documentation will determine the contribution basis – this could reflect the pre-exchange salary.

Impact of opting out

Automatically enrolled jobholders have the choice to opt out of the pension scheme within one month. This means that where a salary exchange arrangement has been used with automatic enrolment, the jobholder's salary should be returned to its previously higher level.

An employer using salary exchange at its staging date could face additional administration in terms of those jobholders choosing to opt out.

ADMINISTERING THE TWO PROCESSES TOGETHER

Clearly there are a number of issues for employers considering using salary exchange with automatic enrolment. An automatic enrolment tool such as Scottish Widows AssistMe can help employers comply with their responsibilities by managing the associated processes. There may not be one right answer but an employer contemplating salary exchange at its staging date might consider:

- Using a postponement period to offer contractual enrolment into the pension scheme in conjunction with salary exchange. Those eligible jobholders not consenting would need to be automatically enrolled on a non-salary exchange basis into the same or a different scheme on the deferral date.
- Automatically enrolling eligible jobholders on a non-salary exchange basis, allowing sufficient time for any opt outs to be processed and then offering salary exchange to this group.

In summary, salary exchange remains a valuable pension planning tool which can operate alongside automatic enrolment and provide an employer with valuable savings.

Every care has been taken to ensure that this information is correct and in accordance with our understanding of the law and HM Revenue & Customs practice, which may change. However, independent confirmation should be obtained before acting or refraining from acting in reliance upon the information given.

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