**Reward & Retirement Provision Assignment 4 Notes**

**(Part 3 – Flexible Benefits and Salary Sacrifice)**

**(Chapter 3 Salary and Bonus Sacrifice - Chapter 4 Other Benefits)**

*Recommended Time: 3 hours*

1. **Write an article for the annual newsletter to the members of a defined contribution pension scheme to explain the introduction of a salary sacrifice arrangement. The key details of the arrangement are:**

* + - **The member contribution rate is currently 5%**
    - **The arrangement will be voluntary, i.e., members need to opt in**
    - **The employer will share 50% of the employer National Insurance (NI) saving with the members by providing a contribution to the pension scheme equivalent to this amount**

**Your article should include an explanation of salary sacrifice and how such an arrangement would operate.**

**You should also include examples of the amount of NI contributions payable by two pension scheme members with pensionable salaries of £36,000 – one who does not participate in the salary sacrifice arrangement and one who does. Your examples should also show the NI contributions that are payable by the employer in respect of the same two members.**

**(The relevant employee/employer contracted in NI contribution rates between the Primary Threshold (£12,570), Secondary Threshold (£9,100) and the Upper Earnings Limit (£50,270) are 12% and 13.8% respectively.)**

**35 marks**

Part 3 Chapter 3.1, 3.2, 3.3, 3.4 and 3.8

Answer should cover:

* + - Explain how salary sacrifice operates and the advantages of such arrangements.
    - Provide example illustrations with and without sacrifice – showing impact on NI Contributions (NIC) (see below)
    - Explain how contributions to the defined contribution scheme increases
    - Mention any adverse implications on state pension

**Illustration:**

Employee NICs without sacrifice = (£36,000-£12,570) x 12.0% = £2,811.60 pa

Employer NICs without sacrifice = (£36,000-£9,100) x 13.8% = £3,712.2 pa

Under a salary sacrifice arrangement, the individual earns £34,200 per annum,

rather than £36,000 per annum. (£36,000 – [5% x £36,000])

**The revised NIC savings are as follows:**

Employee NICs with sacrifice = (£34,200-£12,570) x 12.0% = £2,595.60 pa Employer NICs with sacrifice = (£34,200-£9,100) x 13.8% = £3,463.80 pa

1. **Outline the main reasons why a company may wish to adopt salary sacrifice for their pension scheme.**

**10 marks**

Part 3 Chapter 3.2

Answer should cover:

* + - Promote employee participation particularly amongst employees earning below the Upper Earnings Limit (where the NIC savings are greatest)
    - Assist Recruitment and retention of key staff by making membership of the pension scheme more attractive
    - Platform for introducing a flexible benefits package
    - To take advantage of NIC savings that arise in order to reduce the increasing cost of pension provision.

1. **Outline the minimum requirement for annual leave and how it may be incorporated into a flexible benefit arrangement.**

**5 marks**

Part 3 Chapter 4.1.1

Answer should cover:

The European Union’s Working Time Directive requires employers to give employees a minimum level of holiday each year. For full time employees the requirement is for four weeks annual leave to be given in addition to statutory holidays (bank holidays). Employers are free to offer holidays in excess of this amount. Many employers see offering five- or six-weeks holiday as a way to enrich their benefits arrangements. A common practice is to offer a starting level of holiday at, say, 25 days and allow additional holiday to be awarded on a service-related basis to a maximum, possibly 30 days. The UK has now left the EU, but the above requirements remain part of UK health and safety law. In addition to their annual holiday entitlement, employers may also allow employees to take sabbaticals and career breaks.

1. **To encourage a higher, take up rate of membership of the pension scheme, your client has decided to introduce pension salary sacrifice. Draft a briefing paper to the Benefits Manager setting out the main items to be considered when designing a salary sacrifice arrangement.**

**20 marks**

Part 3 Chapter 3.5

Answer should cover:

• Salary definitions: Since salary is being reduced there are implications for benefits provided by the company which are related to salary and pension benefits which are based on the salary received. To avoid any immediate benefit loss to employees the salary definitions used by both the company and under the pension scheme Trust Deed and Rules would need to be amended, to allow for a salary sacrifice arrangement. It is common that the employer will want to base both pension and other employer provided benefits related to salary on the full (pre sacrifice) salary, and so the salary definitions would need to be amended to refer to this notional salary.

• Refund of contributions: Many occupational pension schemes pay a refund of employee contributions, either on leaving a scheme with less than two years’ service, or on the death of a member before retirement. Under a salary sacrifice arrangement, the employee contributions become employer contributions, and so a refund of employee contributions will yield nothing to the employee. It might be possible to change the scheme rules for death benefits so that the benefit pays out an amount equivalent to the contributions the member would have paid if they had earned the notional salary. For withdrawals, the corresponding payment would be unauthorised and so would not usually be a viable option. The employer could consider making ex gratia payments to members in these circumstances. It is also worth noting that members of occupational defined contribution pension schemes who leave an employer after less than two years of service will no longer be able to take a ‘short service refund’ of any contributions they have paid into that scheme from October 2015. The change will only apply to employees who join a DC occupational pension scheme from October 2015.

• Opt in or opt out: When setting up a salary sacrifice arrangement, there needs to be a default option for members who do not respond to communications. Adopting a default position of moving to the salary sacrifice arrangement, with the option to opt out is likely to lead to a higher take up that having a default position of keeping things unchanged with the requirement to opt into the salary sacrifice arrangement.

• Share the NIC saving: The employer needs to consider whether it wishes to pass any of the employers NIC saving onto employees. It could do this by paying enhanced contributions over and above the salary sacrificed to a DC scheme, or by enhancing some benefits in a DB scheme.

Interaction with automatic enrolment requirements

1. **The HR Manager in your company is concerned that some employees’ state benefits may be adversely impacted by a new salary sacrifice pension arrangement. As Benefits Manager, write an email in response, explaining how salary sacrifice can impact certain state benefits of employees.**

**15 marks**

Part 3 Chapter 3.8

Answer should cover:

When an individual participates in a pension salary sacrifice arrangement, certain State benefits may be affected, where the level of the benefit is determined in relation to the individual’s earnings or the level of NICs that an individual pays. The main benefit that fell into this category was S2P which accrued on an annual basis, dependent on the level of earnings (between the Lower Earnings Level and the Upper Accrual Point) in each tax year. However, this issue falls away under the single-tier State pension.

There are also other consequences of a reduction in salary due to salary sacrifice. For example, the National Minimum Wage and, from April 2016, National Living Wage needs to still be met. For the purposes of this, it is the salary after sacrifice that is important. This can be an issue for low paid workers (including workers earning at or just above the National Minimum Wage / National Living Wage), part timers, and for members who are able to sacrifice a large portion of their salary through high DC or AVC contributions. There is also a potential impact on numerous other State benefits, such as:

• Incapacity Benefits and Job Seekers Allowance

• Statutory Sick/Maternity Pay, and other “statutory” pay

• Working/Children’s Tax Credit.

For a number of these benefits, it is important that the salary after sacrifice does not fall below the LEL. For the Tax Credits, salary sacrifice could actually increase the benefit payable.

1. **Explain the difference between a career break and a sabbatical and why an employer may offer them to employees.**

**10 marks**

Part 3 Chapter 4.1.1

Answer should cover:

Sabbaticals are extended breaks from employment that are additional to holiday entitlement and may be paid. Companies will often now use sabbaticals as a means to reward length of service and to help employees achieve a better “work/life balance”. Each company will have different restrictions which apply. Employees may have to meet certain minimum qualifications (e.g., only available to permanent employees after a minimum period of service and a certain period after a previous sabbatical). The length of the sabbatical may be restricted. The sabbatical may also have to be used for certain activities (e.g., voluntary work or academic research).

Career Breaks Career breaks are extended breaks from employment and are usually unpaid. The majority of companies will guarantee a suitable job on return to work. Reasons for introducing a career break include:

• attracting high calibre employees by showing a commitment to their long-term career

• retaining staff with experience and skills

• reducing the number of employees who leave

• a commitment to provide equal opportunities

• to help women combine a career and family responsibilities

• in some cases, to provide a pool of skilled labour to be called upon for holiday or sickness cover, or to cover peak workloads.

1. **Outline the two types of dental cover that companies may offer employees as part of their benefits package.**

**5 marks**

Part 3 Chapter 4.2.1

Answer should cover:

Capitation plans

Can be offered by both private and NHS dentists

Designed to meet the cost of all dental care Individual is assessed on the state of their oral hygiene, and this then determines the monthly cost of the cover

Typically set up on an individual basis

• Dental insurance:

Covers both NHS and private dentistry

The level of cover can be on a number of bases, i.e., to cover NHS costs or different levels of private dentist costs

Can be extended to include the employee’s family

Dental insurance is typically offered as part of a voluntary benefits plan or within a flexible benefits plan.