AUTO-ENROLMENT: HOW TO … … OPERATE SALARY SACRIFICE ALONGSIDE AUTOMATIC ENROLMENT

INTRODUCTION

It is now just over a year since the first employers reached their automatic enrolment staging dates and therefore many of the practical issues that arise for employers when implementing the reforms are now apparent. Updated versions of the guidance on certification of the quality requirement were issued in September and amendments designed to introduce technical improvements to the legislation to take account of practical experience came into force at the beginning of this month.

It therefore seems an appropriate time to look at some of the trickier practical issues that arise with automatic enrolment. There is no single answer to many of these issues, but in this series of three alerts we will look at practical steps employers can take to ensure compliance with the duties. In this second edition, we look at salary sacrifice.

There are three key issues for salary sacrifice in the context of automatic enrolment: whether it can act as a barrier to entry to a scheme; assessing the worker's earnings to decide if they are eligible for automatic enrolment; and assessing whether the scheme meets the relevant quality requirement.

The terms eligible jobholder and non-eligible jobholder used in this alert have the same meanings as used in the Pensions Regulator's guidance and commonly throughout the industry - the terms are explained in the first of our alerts in this series.

A RECAP ON SALARY SACRIFICE

A salary sacrifice occurs when an employee gives up the right to part of their salary in return for some form of non-cash benefit. In the case of pension contributions, salary sacrifice operates by reducing the employee's gross pay with the employer making a contribution (or increased contribution) to the scheme. The advantage of this is that neither employee nor employer National Insurance contributions are payable on the amount contributed by way of salary sacrifice.

This note looks at the interaction of salary sacrifice with the automatic enrolment legislation. However, when using salary sacrifice it is also important for employers to ensure that their arrangements meet strict HMRC requirements in relation to the contractual arrangement between the employer and the employee in order to be effective. For further information on HMRC's requirements please ask for our leaflet "Pension contributions and salary sacrifice". We suggest that advice is taken before implementing salary sacrifice to ensure that your arrangements are effective.

BARRIERS TO ENTRY

The criteria to be an automatic enrolment scheme include that the jobholder cannot be required to take any action or provide any information in order to become or remain a member of the scheme. This means that jobholders cannot be asked to agree to a salary sacrifice arrangement as a condition of becoming or remaining a scheme member.

There are different strategies that employers can use to address this issue and we set out a brief overview of the main options. Each of these has different advantages, disadvantages and complexities and therefore we suggest that employers seek advice on dealing with the interaction of salary sacrifice with the automatic enrolment legislation before deciding how to implement this.

Option 1 - Automatically enrol with the option for salary sacrifice

Employers could simply automatically enrol eligible jobholders (and enrol non-eligible jobholders on request) with contributions made by deduction from salary in the standard way but give members the option, once in the scheme, to opt for salary sacrifice.

Option 2 - Try to obtain consent in advance of the automatic enrolment date

Employers could use a postponement period so that jobholder status does not need to be assessed for up to three months. During the postponement period, the employer could seek the jobholder's agreement to salary sacrifice and either:

- use that agreement as the means by which to contractually enrol the jobholder into the scheme so that at the end of the postponement period no duty arises because the jobholder is already a member of a qualifying scheme; or
- automatically enrol the jobholder where required under the legislation at the end of the period but knowing that the agreement is in place to use salary sacrifice.

In either case, if any eligible jobholders do not agree to use salary sacrifice, they would need to be automatically enrolled at the end of the postponement period paying contributions by way of deductions from salary. Likewise, any non-eligible jobholders who make an opt in request but have not agreed to the use of salary sacrifice, must be enrolled with contributions being paid by way of deductions from salary.

In the case of jobholders who join the workforce after the staging date, there may be time to complete this process in advance of employment commencing and therefore automatically enrol the jobholder from day one rather than using a postponement period. Of course, the employer could still use a postponement period if it wishes to do so.

Option 3 - Make salary sacrifice the default option

Some employers may prefer all of their scheme members to use salary sacrifice (except for those in respect of whom it is not legally possible, for example, because it would cause earnings to fall below minimum wage).

To give effect to this, employers may write something into the employment contracts with jobholders so that salary sacrifice is automatically used, although the jobholder is given the right to opt out of salary sacrifice but stay in the scheme.

For jobholders who join the workforce after the staging date, standard form employment contracts can be amended to incorporate wording to state that salary sacrifice will automatically apply and therefore the jobholder's consent will be achieved when they sign the contract.

For existing jobholders who are not in the scheme on the staging date and whose contracts do not contain such a provision, employers could either go through the process of seeking consent or may instead seek to introduce a unilateral contract change by informing the jobholder of the introduction of salary sacrifice.

Unilateral change to the employment contract carries the risk of claims for unlawful deductions from salary, but that risk is mitigated by the fact that the use of salary sacrifice is to the jobholder's benefit overall, and the jobholder can opt out of salary sacrifice if they wish to do so.

A note on ceasing salary sacrifice

It is important to note that in order that the need for continued agreement to pay contributions by way of salary sacrifice does not act as a barrier to the jobholder remaining in the scheme, there should in all cases be an option for jobholders to cease contributing by salary sacrifice but remain in the scheme.

A note on communications

The Pensions Regulator's guidance suggests giving information on salary sacrifice separately to any enrolment information in respect of automatic enrolment. It also states that it is important that communications about salary sacrifice are carefully worded so as not to give the impression that a person will only be automatically enrolled if they agree to use salary sacrifice.

ASSESSING EARNINGS

When assessing whether a worker is eligible to be automatically enrolled or has the right to opt in with or without employer contributions, one of the factors to consider is the level of the worker's qualifying earnings.

The legislation does not state whether it is the pre or post sacrifice earnings that should be used.

Using post-sacrifice earnings would be consistent with the Pensions Regulator's approach on assessing scheme quality (see overleaf) but this could give the seemingly counter intuitive outcome that by electing for salary sacrifice of pension contributions, the earnings dip below the threshold and the worker does not qualify for automatic enrolment in the first place.

In contrast, if the employer uses the pre-sacrifice salary, whilst this ensures that nobody is inadvertently omitted from automatic enrolment, there is a risk that some jobholders will complain that they have been automatically enrolled and contributions have been deducted even though they did not in fact meet the relevant earnings threshold. In our view, this is the safer option as individuals can opt out of the scheme and receive a refund of their contributions if they wish.

ASSESSING SCHEME QUALITY

The Pensions Regulator's guidance states that when calculating the minimum contributions payable to a DC scheme, the qualifying earnings to use to meet the minimum requirements are the post-sacrifice level of salary.

However, by referring to qualifying earnings, this statement appears to relate to standard minimum contributions and is not expressly stated also to apply to contributions payable where the employer is using one of the alternative sets of contributions under certification.

For employers who prefer to avoid any risk of paying insufficient contributions by using the pre-sacrifice salary for the purpose of calculating the contributions to the scheme, it is important to note that there is nothing in the legislation to prevent a scheme requiring contributions of more than the statutory minimum. This is subject to the need for the employer to ensure that deductions from the jobholder's salary are lawfully made.

FURTHER INFORMATION

Please click here to access other alerts that we have issued on automatic enrolment as well as our monthly Pensions News publication which contains a section on the latest developments in automatic enrolment.

If you would like to discuss the issues raised in this alert or any other aspects of automatic enrolment, please get in touch with your usual DLA Piper contact or contact Tamara Calvert. If you would like to discuss the tax aspects and HMRC requirements of salary sacrifice, please contact Lynda Finan.

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