

# Auto-enrolment – at what cost?

by **Mark Pemberthy** on May 16, 2011 at 11:18



**The move towards auto-enrolment into workplace pension schemes could hit UK businesses where it hurts unless employers put a strategy in place to limit the damage, writes Mark Pemberthy, projects director at JLT Employee Benefit Solutions.**

The introduction of auto-enrolment into workplace pension schemes marks a significant step towards achieving better retirement provision for UK employees. But it also heralds an increase in pension costs for virtually all UK employers.

As well as the additional contributions employers will be obliged to pay, the financial exposure potentially extends to a long list of incremental direct and indirect costs.

When a business faces increased costs there are a number of possible outcomes: seek to reduce costs in other areas, increase productivity or prices, or suffer reduced profits. These all pose different challenges and it is inevitable that employers will consider ways in which pension costs can be minimised or shared with employees. Fortunately, there are a number of pension and benefit strategies employers can explore.

## Exploring the options

When Australia first introduced compulsory employer contributions in 1986, they were promoted as a 3% wage rise granted by the government. It is optimistic to think UK employees will view an employer pension contribution in the same way as a pay rise, but the concept is relevant.

The introduction of mandatory employer contributions is phased in 1% increments and does not reach 3% until 2017. This gives the opportunity to incorporate new employer pension contributions within normal remuneration increases. For example, a 3% annual remuneration increase could be structured as a 2% salary rise and a 1% pension contribution.

Employer pension contributions are not liable to employer national insurance (NI) contributions, so an increased pension contribution is more efficient than paying additional salary. This strategy is dependent on consistent pay awards over the coming years and there is a risk of resistance from employees after several years of flat or negative wage growth.

A more extreme way of managing the extra cost is to absorb it in the existing reward budget, perhaps by reducing existing pension contribution rates, scaling back on other benefits or reducing the headcount.

Auto-enrolment is yet another catalyst for employers with defined benefit pension schemes to stop or reduce future accrual, increase employee contributions or change scheme design.

Other employee benefits should also be reviewed. Get feedback from employees and focus on the value the employer and employee are achieving for the benefit spend. Any benefit that is expensive for the employer but unappreciated by employees is an immediate opportunity to redirect budget to the pension scheme.

Where defined contribution (DC) rates are higher than the qualifying levels there may be a temptation to reduce these, either for new entrants or for the membership as a whole, subject to contractual and consultation requirements. There has been widespread concern over the possibility of 'dumbing down' and the knock-on effects this would have on overall retirement provision. Although the National Association of Pension Funds has taken a positive step in encouraging employers to improve levels of pension saving in the workplace through the introduction of the Pension Quality Mark, this remains an obvious option for employers.

Even if DC contribution rates do fall in the short term, they should increase over time. The removal of the default retirement age will encourage employers to make sure employees can afford to stop working at an appropriate time and the most effective way of achieving this is through realistic levels of workplace pension saving.

## **Making sacrifices**

The NI efficiency of employer pension contributions is the driver for pension salary sacrifice, also known as Smart pensions and salary exchange. Pension contributions made by an employee qualify for income tax relief but do not attract any relief against employer or employee NI, whereas an employer pension contribution is not liable to NI for the employee or employer.

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