

Agenda item:

Title of meeting: Employment Committee

Date of meeting: Tuesday, 14 June 2016

Subject: Shared Cost Additional Voluntary Contribution Scheme

Report by: Shaun Tetley, Payroll and Pension Manager

Wards affected: None

Key decision: No

Full Council decision: No

1. Purpose of report

- 1.1 This report seeks approval to implementing a shared cost salary sacrifice additional voluntary contribution (SSAVC) pension arrangement.

2. Recommendations

- 2.1 Employment Committee approve the implementation of a shared cost salary sacrifice additional voluntary contribution (SSAVC) pension arrangement for members of the Local Government Pension Scheme (LGPS).
- 2.2 Employment Committee approve that earnings related payments, such as overtime, pay rises and redundancy are calculated on the notional salary and not the reduced sacrificed salary. Section 3.6 below gives further details.
- 2.3 Employment Committee approve the inclusion of a new discretion in the Council's Discretionary Pension Policy Statement to authorise shared cost SSAVCs as one of our discretions. Section 3.7 below gives further details.
- 2.4 Employment Committee approve the implementation of a shared cost SSAVC scheme for members of the Teachers and NHS Pension Scheme, subject to this being approved by the relevant authorities.

3. Background

- 3.1 Members of the LGPS already have the option to contribute to additional voluntary contributions (AVCs) and receive tax relief on the amount they pay through their payslip. AVCs are effectively a long term savings plan that runs alongside the mainstream LGPS that allow a member to build up a capital sum with flexible drawdown options at retirement.

- 3.2 The Council (through Hampshire Pension Fund) administers two AVC schemes and the providers are Prudential and Zurich and this arrangement would not change with the introduction of a shared cost SSAVC scheme.
- 3.3 The Council has recently identified that scope exists to implement a shared cost SSAVC scheme for members of the LGPS. The advantages of implementing this new arrangement over the current scheme is that in addition to the tax relief that is currently received, the employee will pay lower national insurance contributions. In addition the Council will benefit from a reduction in the employer national insurance contributions.
- 3.4 The Chancellor of the Exchequer has recently said that he is concerned over the proliferation of salary sacrifice schemes and there may legislation enacted to restrict schemes of this nature. However, in the March 2016 budget, the Chancellor indicated that salary sacrifice pension arrangements are unlikely to be affected by any legislative change and this is another good reason to proceed with the new scheme.
- 3.5 To ensure that the arrangement is compliant with the LGPS regulations, the SSAVC has to be set up as a shared cost scheme which means that both the employee and employer has to contribute to the SSAVC. Although this suggests that the Council has to actually pay its own contribution into the shared cost SSAVC plan, in reality this is not the case. How it actually works in practice is that the employee agrees to take a contractual reduction in salary, equivalent to the amount of SSAVC's they would like to contribute and the Council then pays this amount into the shared cost SSAVC plan on their behalf. This does not meet the shared cost requirement as effectively it is only the Council who is paying into the SSAVC plan. To ensure compliance with the LGPS Regulations, the employee would also need to pay at least a nominal £1 a month into the AVC fund via a payroll deduction. Appendix 1 of this report provides an example of how the current and new SSAVC scheme operate and the savings available.
- 3.6 Recommendation 2.2 covers the treatment of earnings related payments for staff who opt for shared cost SSAVCs. Members can decide whether earnings related payments such as overtime, pay rises and redundancy are calculated on the notional salary or the reduced sacrificed salary. If we use the reduced sacrificed salary, staff will see a reduction in their pay on earnings related payments and it is strongly recommended that we use the notional salary. Without this approach the incentive for staff to move to the new salary sacrifice scheme will be significantly diminished and we will not make the anticipated employer savings.
- 3.7 The current Pension Discretionary Pension Policy Statement will need to be amended and published to give the Council the necessary discretion to implement a shared cost SSAVC. Details of the new discretion are shown in the table below.

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|----------------|---|
| New discretion | Under Regulation 17 of the LGPS Regulations 2013, Portsmouth City Council will exercise the discretion to allow Local Government Pension Scheme members to contribute to a shared cost salary sacrifice additional voluntary contribution scheme. |
|----------------|---|

- 3.8 An amendment will need to be made to the statement of particulars for any member of staff who signs up for a shared cost SSAVC to ensure that their LGPS pensionable pay is not affected. Without this change there could be a significant reduction in a members retirement benefits.
- 3.9 There are a number of advantages of implementing a shared cost SSAVC and these are:
- Staff who contribute to a LGPS shared cost SSAVC scheme will see a reduction in national insurance contributions (NICs). For most staff this will result in a 12% reduction in their NIC contributions on the SSAVC amount and this will act as an important incentive to help save towards pension provision for both existing and new SSAVC contributors.
 - Some salary sacrifice schemes reduce pensionable pay and ultimately reduce the scheme member's main pension benefits on retirement. This does not apply however to shared cost SSAVCs as long as we make appropriate amendments to the statement of particulars.
 - There will be a reduction in employer NICs of approximately 13.8% on the total value of the SSAVCs. Provided that the majority of staff who pay into the existing arrangement transfer to the new shared cost SSAVC, it is estimated that this will result in a saving of £150,000 per annum in employer NIC contributions. We expect that most staff will transfer to the new scheme on the basis that it will result in an increase in take home pay.
 - The savings that are available to both the employee and employer will depend on the shared cost SSAVC amount the employee chooses to pay and the amount an employee earns. As an example, staff who receive less than £43,000 salary and pay £100 each month into a shared cost SSAVC will save £144 each year in NIC contributions and the employer will save £166. The saving for staff on pay of greater than £43,000 is lower due to reductions in the NIC percentage thresholds.

4. Implementation issues

- 4.1 The key to a successful SSAVC implementation will be to communicate the changes effectively to all existing LGPS AVC contributors to help them understand the financial benefits of transferring to the scheme. This will be achieved by a comprehensive set of frequently asked questions, personal letters, presentations and intranet content. We expect that most members of staff will opt for the new shared cost SSAVC scheme on the basis that they will see an increase in their take home pay.
- 4.2 The Council is working in partnership with the Local Government Pensions Committee and the main national AVC provider (Prudential) to ensure that the shared cost SSAVC scheme is compliant with the LGPS Regulations.
- 4.3 The new shared cost SSAVC scheme will act as an important incentive for staff to contribute to AVCs. This is likely to lead to an increase in the number of new AVC contributors and existing AVC contributors increasing the amount they pay. This in turn will lead to greater NIC savings for both staff and the Council. We currently present regular pension talks to staff and AVCs are covered during these sessions.

The content will be modified to highlight the additional financial advantages of shared cost SSAVCs but we will not provide any financial advice.

- 4.4 The new shared cost SSAVC will require some additional employer checks to ensure that the AVC deduction do not reduce the employee's income below the appropriate minimum level for that individual. The HMRC website states: "A salary sacrifice arrangement cannot reduce an employee's cash earnings below the National Minimum Wage rates." This likely to affect very few staff, if any.
- 4.5 We have identified only two employers in the UK who have to date implemented shared cost SSAVCs and it is critical that we ensure that the scheme documentation is HMRC compliant. Without a compliant scheme we will have to repay the savings we have made in employee's and employer's NIC contributions to HMRC and will face interest and penalties charges. To ensure that the scheme is HMRC compliant, we intend to use the Council's tax advisors to construct the scheme and obtain HMRC approval. We have negotiated a fixed charge of £4,500 for this work.
- 4.6 HMRC will not provide approval of any salary sacrifice scheme until it is 'live'. This adds an element of risk if we undertake a full scale launch without the necessary clearance. If for some reason HMRC reject the shared cost SSAVC scheme, we would need to repay the employee and employer NIC savings, and close the scheme down. To avoid this we will go live with a single member of staff and apply for clearance before doing a full scale launch.
- 4.7 When the scheme is fully live, any member of staff who applies for an AVC in the future will automatically be entered into the new shared cost SSAVC arrangement by default but they will have the option to join the original standard AVC scheme if they wish.
- 4.8 We are currently investigating the scope to implement a shared cost SSAVC for members of the NHS and Teachers Pension schemes. If we are successful in obtaining clearance we propose to implement SSAVC's for these schemes. This should lead to the same benefits outlined above for both the employee and employer.

5. Equality impact assessment (EIA)

A preliminary or full equality impact assessment is not required as this report does not result in any equality issues .

6. Legal implications

The legal implications and requirements are critical to ensure that:

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- The scheme, frequently asked questions and salary sacrifice contractual documentation meets HMRC salary sacrifice legislation to ensure that the SSAVC scheme is compliant. To avoid any complications, the scheme will be submitted to HMRC for approval.

- The Council's discretionary policy is amended and published to include a new discretion to allow shared cost AVCs
- An amendment is made to the statement of particulars for staff that elect to join SSAVCs to indicate that the AVC contributions are considered to be a pensionable emolument. This will ensure that there is no reduction to a members pensionable pay.
- The report clearly identifies the risks and makes appropriate recommendations to avoid any potential loss to contributors with regard to the LGPS and seeks to maximise tax efficiencies to be delivered to both the employee and employer. This comment is set against the additional reassurance that all current AVC holders will receive full briefing and the current proposal is being reviewed by external tax advisors to ensure current HMRC compliance.

7. Finance comments

The estimated employer NIC savings based on the likely take up of staff that transfer from the existing AVC arrangement to a shared cost SSAVC is expected to be £150,000 in a full year. To ensure that the scheme is constructed in a legally compliant manner, it is proposed that we use the Council's tax advisors to provide the necessary advice and documentation and they will also organise the HMRC approval of the scheme. The cost of this will be £4,500 and it is critical that we utilise their professional support to avoid compliance issues. The advantage of using our current tax advisors is that they have experience of implementing and obtaining HMRC approval of salary sacrifice schemes in the public sector.

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Signed by:

Background list of documents: Section 100D of the Local Government Act 1972

Local Government Pension Scheme (LGPS) Regulations 2013

The recommendation(s) set out above were approved/ approved as amended/ deferred/ rejected by on

Appendix 1

Example of shared cost AVC

Richard wants to pay £5000 a year into the LGPS AVC scheme and earns £40,000 a year.

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| The current AVC scheme |
| Under the current AVC arrangements Richard would agree to pay £5000 by regular monthly deductions from his pay and he would get tax relief on his AVC payments, but his National Insurance would be calculated on gross earnings of £40,000. For tax deduction purposes his salary would be £35,000 For NIC purposes his salary would be £40,000 |

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| The new shared cost SSAVC scheme |
| Under the new shared cost SSAVC scheme, if Richard agrees to his salary being reduced to £35,000 a year and the Council pays £5000 into the AVC fund on his behalf, he would get the same tax relief but also pay less NICs For tax purposes his salary would still be £35,000 But for NIC purposes his salary would now be £35,000 so he would pay lower NICs The Council would also make a NIC saving on the £5,000 reduction in pay. As the AVC is required to be established on a “shared cost” basis, this means that both the employer and employee have to pay into the arrangement. Where Richard accepts a reduction in pay from £40,000 to £35,000, the Council would agree to pay £5000 into his AVC plan which is effectively the employer contribution and this makes the scheme compliant with the “shared cost” requirement. Richard would also need to pay at least £1 a month into the AVC fund via a payroll deduction. This would be in addition to the £5000 AVC payment made by the Council. |

The effect on take home pay and employer NIC saving on the example above is as follows:

| <u>The current AVC scheme</u> | | <u>The new shared cost SSAVC scheme</u> | |
|--------------------------------------|-----------------------|--|-----------------------|
| Monthly Pay | £3,333 | Monthly Pay | £2,916 |
| Income Tax | £354 | Income Tax | £354 |
| NI | £319 | NI | £269 |
| LGPS | £226 | LGPS | £226 |
| AVC | £417 | AVC | £1 |
| <u>Net pay per month</u> | <u>£2017</u> | <u>Net Pay</u> | <u>£2066</u> |
| <u>Net pay per annum</u> | <u>£24,204</u> | <u>Net pay per annum</u> | <u>£24,792</u> |

As you will see the take home pay has risen from £2,017 to £2,066, an increase of £49 every month. He has still had £417 (£5,000 ÷ 12 + £1) paid into his AVC fund for that month and their LGPS contribution is still based upon the reference pay of £3,333 (£40,000 a year).

In this example the Council would save £691 per annum in employer NIC contributions.