10 Mar 2021

Workplace pensions

Learn about the UK legislation surrounding workplace pensions and how to choose new schemes or review existing pension agreements

Introduction

Since automatic enrolment, the decision regarding workplace pensions comes down to how much the employer should contribute. Workplace pensions need to be continually reviewed in line with an ever-changing body of legislation. Employers should invest in effective employee communication and education, not only to meet legal requirements and ensure employees understand their pension and retirement options and the decisions they need to make, but also to raise awareness of the value of the benefit being offered.

This factsheet explores the different types of workplace pension and the UK legislation governing them. It addresses strategic issues with a series of questions and reflections to use when reviewing existing arrangements.

What are workplace pensions?

Workplace pensions, also known as occupational pensions, are arranged by employers rather than by the state or an individual. The employer, and usually the employees, are required to contribute to the fund.

The two main types of workplace pension are:

- **Defined contribution (DC) schemes** (also known as money purchase schemes) where the income on retirement depends on factors such as stock market performance, the amount of money contributed and related charges and fees. DC schemes are either contract-based (provided by a third-party) or trust-based (run by an employer through a board of trustees). DC plans open to all employees are typically found in the private sector.

- **Defined benefit (DB) schemes** (such as career average or final salary schemes) where the income on retirement is effectively guaranteed by the employer. Many of these schemes have been closed to new employees. Open DB schemes are usually found in the public sector.

There are also certain 'hybrid' arrangements, for example 'cash balance' or 'collective DC' schemes. In the UK, the Pensions Schemes Act 2021 provides a framework for collective DC pension schemes to encourage more employers to adopt this approach to pension provision.

Pensions are a complicated subject and no action should be taken without professional guidance.

Corporate responsibility principles should play an important role in workplace pension provision and enable individuals to make a positive social impact through their personal investment choices.

Pensions in the time of coronavirus

The COVID-19 pandemic has had repercussions for DB, DC and hybrid pensions, including implications for pension contributions (including salary sacrifice), deficit recovery plans, member communications, scams and the Coronavirus Job Retention Scheme. There's more on these topics on the Pension Regulator's webpage COVID-19 (coronavirus): what you need to consider.

The UK legal and regulatory position

An ever-growing body of UK legislation governs employers' pension arrangements.

Pension contributions and benefits are influenced by HM Revenue & Customs limits and vary from time to time. Further details and the latest figures are available from the HMRC.

CEO pensions

Pension arrangements for CEOs have received attention in recent years. The UK Corporate Governance Code 2018 states: "Only basic salary should be pensionable. The pension contribution rates for executive directors, or payments in lieu, should be aligned with those available to the workforce. The pension consequences and associated costs of basic salary increases and any other changes in pensionable remuneration, or contribution rates, particularly for directors close to retirement, should be carefully considered when compared with workforce arrangements." In response, many listed companies are reducing the generosity of their executive pension plans. There's more on CEO pension arrangements in our report Executive pay in the FTSE 100: 2020 review.

Auto-enrolment

Automatic enrolment has been a major development. It requires all employers to automatically enrol eligible workers into a qualifying workplace pension scheme (unless the worker chooses to opt out) to which the employer must also contribute.

From 6 April 2019, the total minimum contribution is 8% (with at least 3% being contributed by the employer). The yearly administration charges and management fees a pension company can charge are currently capped at 0.75%.

Employers must re-enrol eligible staff who opt-out of a qualifying automatic enrolment pension scheme. Automatic re-enrolment occurs every three years after the employer's staging date and is basically a repeat of the duties that were carried out at that staging, or deferral, date if postponement was used.

The government published a review of automatic enrolment in 2017, which made a number or recommendation. These are yet to be implemented.

More help is available from the Pensions Regulator, the Department for Work and Pensions and the Chartered Institute of Payroll Professionals.

Access to pension pots

Employees now have more freedom over how they take their money from their pension. The choices affect those aged 55 and over, especially those who have a DC pension. For instance, an employee in a DC scheme is no longer required to buy an annuity with their fund and can choose to go into 'drawdown' or take it as cash. The government plans to increase the normal minimum pension age from 55 to 57 by April 2028.

To help workers make informed decisions, the UK government has created Pension Wise, a free and impartial service, offering guidance on any tax and benefit implications as well as warning signs of a pension scam.

Employers are required to give their people who are members of their workplace DC pension information about their options and the decisions they need to make. This includes telling them about the Pension Wise service.

Strategic issues in workplace pensions

Workplace pension provision is a significant issue for employers. In many organisations, access to a workplace pension forms an integral and valuable element of employee financial well-being.

Since 2000, the workplace pension landscape has been shaped by:

- Insufficient investment returns and low yields to help fund DB pensions pots.
- Increased longevity meaning more years in retirement for many people.
- Greater flexibility in working patterns.
- The end of the default retirement age for most occupations.
- Increasing pension regulation.
- Introduction of auto-enrolment.
- Ending the requirement to buy an annuity.
- Changes to pension tax relief.
- The increases in the state pension age.
- Greater access to pension pots.
- Ending the 'contracting out' of pensions.
- The flat-rate state pension introduced in April 2016.

Our survey of employee attitudes to pay and pensions finds many employees are unsure about the new state pension in terms of what they can expect to receive and when. This is important as the state pension is expected to play a role in their decision to retire from paid employment. If they defer their retirement, this will have implications for how employers recruit, manage, develop and reward their workforce.

Organisations planning to review their existing pension arrangements should ask themselves the following questions.

Why have a workplace pension scheme?

As all employers are required to automatically enrol eligible workers into a qualifying workplace pension scheme, the decision isn't whether to offer access to a pension scheme, but:

- Which specific type of scheme (or schemes) to operate.
- How much to contribute.
- How much choice to give employees.
- What level of financial education and communication to give to employees.

Workplace pension plans are influenced by:

- Meeting legal and regulatory requirements.

- Offering a pension plan that is aligned with the organisation's business objectives.
- Providing a competitive benefits package to aid the recruitment and retention of employees.
- Meeting the future needs of employees for their financial well-being, which may in turn help to fulfil a sense of moral duty or to enhance employee engagement.
- Responding to the environmental, social and governance (ESG) concerns of investors and customers.
- Allowing members to better align their pension savings with their beliefs and increase positive social impact through their investment choices in workplace pension plans.
- Having a scheme that supports the organisation's corporate responsibility strategy.
- Managing pension costs effectively.
- Helping employees to leave the organisation when they wish.

Do employees currently value pension benefits as part of the remuneration package?

After salary, pension schemes can be the costliest element of the remuneration package for many employers. For a pension to be an effective benefit, employees must understand its value to them.

In general, pension arrangements that are simple to understand are more likely to be appreciated by employees. However, the degree of flexibility and choice within a pension scheme should depend on the profile of the workers. For example, a pension scheme offering a wide range of sophisticated investment choices may be suited to a financial services company but less appropriate for a catering firm.

Is the value of the pension benefit effectively communicated?

As our report Show me the money! highlights, behavioural science research shows that employees tend to under-value rewards they can't enjoy immediately. To counteract this, employers need to invest in effective communication and education to raise awareness and understanding of their pension scheme.

To communicate effectively about pensions:

- Conduct research into the level of employee understanding and the challenges you may face in getting your communication across.
- Slogan and messaging should reflect the employer purpose, mission and culture.
- Material should be targeted and written plainly.
- Messages should take account of employees' non-financial values, such as social

impact, and explain how they can invest their pension benefits in a way that supports and enhances these values.
- Line managers should be involved where appropriate, for example in cascading announcements of change rather than in a detailed technical capacity.
- Messages should cover what the scheme is and how it works, but also why retirement saving is important for financial well-being.
- Explain how the new state pension currently works, because many people are unaware of the new arrangements.
- Highlight other sources of information, such as Pension Wise.
- Avoid confusion between financial education and financial advice, as the latter is covered by specific regulations.
- Have measures in place to help evaluate the impact of your communication and make any necessary adjustments to your existing approach.

Are employees financially aware?

Investing in an excellent pension scheme to help attract, retain and engage staff may be wasted if employees lack financial understanding. Our report on employee financial well-being shows how financial concerns can affect employee mental and physical health and the impact that this has on business performance. It also provides help for organisations wanting to improve their employees' financial awareness.

What culture does the organisation wish to foster?

When designing pension arrangements, it’s important for employers to consider the role they want to play in employees’ retirement planning, such as in the design of a DC default fund, the level of contributions and financial awareness campaigns.

Does the organisation wish to differentiate pension benefits on grounds of employee preferences?

Employees can have differing attitudes to pensions. For example, senior staff may find it more attractive than young recruits who initially may be more interested in saving for a first home. Within a DC plan, flexible benefit schemes can give employees the option of contribution rates that allow them to make variable payment levels as desired, at different stages of the work or life cycle, subject to annual and lifetime contribution allowances. Again, as well as providing choices to employees, employers need to highlight the potential consequences of these choices to their people.

Has the organisation acquired, or does it intend to acquire, other companies?

In cases of merger and acquisition, it's likely that a variety of types of pension arrangement will operate. This can make pension management complex and limit a coherent remuneration approach. In these circumstances, a flexible remuneration strategy, including flexibility in pension level design, can be beneficial.

Is the organisation an international company?

A multinational company may wish to harmonise its pension arrangements. However, differing tax and social security laws internationally will make this difficult. Consistent principles can, however, be applied and global companies usually need to set a framework within which retirement benefits are designed and funded worldwide. As a minimum, organisations should ensure that internationally mobile employees are covered by coherent pension arrangements.

Useful contacts and further reading

Contacts

GOV.UK - Set up and manage a workplace pension scheme

HM Revenue & Customs - pension scheme administration

The Pension Service - for State Pension eligibility, claims and payments

Pension Wise

Pensions Management Institute (PMI)

Books and reports

CMS PENSIONS TEAM. (2021) *Pensions law handbook*. 15th ed. London: Bloomsbury Professional.

FINCH, D. and PACITTI, C. (2021) *Building a living pension: closing the pension savings gap for low to-middle income families*. Resolution Foundation.

RACONTEUR. (2018) *Workplace pensions*. 28 February. Distributed in *The Times*.

Journal articles

BASKA, M. (2018) Employers 'must do more' as figures show almost half of staff contribute bare minimum to pension. *People Management* (online). 9 May.

BROWN, D. (2019) Are CDCs the middle-way solution to the UK's pension crisis?*People Management* (online). 27 March.

CRUSE, V. (2021) Pensions changes to be aware of in 2021. *People Management* (online). 27 January.

Will collective defined contribution schemes take off? (2020) *Financial Times* website. February.

Members and *People Management* subscribers can see articles on the *People Management* website.

This factsheet was last updated by Charles Cotton.