Setting up **salary exchange**

THIS IS FOR EMPLOYER USE ONLY AND SHOULDN'T BE RELIED UPON BY ANY OTHER PERSON.

Once you've decided that a salary exchange, or salary sacrifice, arrangement is right for your business there are a few things to consider before setting up.

This guide aims to help you understand what you need to think about and when a financial adviser, employment law specialist or Royal London can best support.

Setting up your arrangement

Follow this step by step guide to setting up your salary exchange arrangement successfully.

Royal London can't provide financial or legal advice, so if you're unsure about salary exchange, we recommend speaking to a financial adviser and/or employment law specialist.

Can your payroll provider support salary exchange?

The first step is reviewing your payroll system to understand what support it can provide for administering salary exchange. You should consider which reinvestment options your payroll supports, if it can calculate pension contributions, take-home pay and any opt out refunds.

Who can join your salary exchange scheme?

Salary exchange might not be appropriate for all of your employees.

You can offer salary exchange to some or all of your employees as long as it doesn't reduce their take-home pay to less than National Minimum Wage or National Living Wage. For employees who aren't eligible, or choose to opt out, you'll need to make pension contributions on a relief at source basis, after tax has been deducted.

It's important to monitor this on an ongoing basis as changes to working hours, or contracts, can affect suitability.

You should also consider how you'll manage employee requests to opt in to your salary exchange arrangement after opting out. Will you allow them to do this at any time, or during a set benefits window for example, that falls at a particular time of year?

What changes are required to employee contracts?

A salary exchange agreement must be detailed in your employment contracts, and your employees must agree to it. If you're making changes to an existing contract a consultation period may be required to explain the changes.

Will you keep or reinvest your savings?

A key decision when setting up your arrangement is whether you'll:

- keep all of your National Insurance contribution (NIC) savings;
- reinvest all your NIC savings into your employees' pension plans; or
- a bit of both - keep some for your business, but also pass some back to your employees.

You should then apply this at scheme level.

Keeping all of your NIC savings gives you the option to help reduce your costs and reinvest in your business, whereas reinvesting some or all of the savings you make back into your employees' plans, can help increase your scheme take up, and improve your employee benefits package.

If your payroll system isn't able to calculate any reinvestment automatically, this may increase your administration.

Will you reinvest employee NI savings or allow them to increase their take home pay?

You can decide if your employees National Insurance savings are reinvested into their pension or added to their take home pay.

You should apply this decision at scheme level rather than individual employee level.

If your payroll system isn't able to calculate any reinvestment automatically, this may increase your administration.

Do you want to set a minimum salary threshold?

Setting a minimum salary threshold can be a simple and effective way of ensuring any employees who decide to exchange part of their salary, keep their final take home pay above the National Minimum Wage or National Living Wage.

Any contributions paid into the plan will follow the usual pension tax relief rules.

Will salary exchange be your default pension option?

You can set salary exchange as the automatic default option for your pension scheme. This means that any new employees can be automatically enrolled into this arrangement.

To do this, it must be written into your employees' employment contract with an agreement letter or opt-out form.

Updating employment contracts

You have a legal requirement to update your existing employees' employment contracts, to make it clear that a salary exchange arrangement is in place. If you take on any new employees in the future, you may want to consider building this into your recruitment processes and their initial contract of employment.

It's important to update the contracts before any salary is exchanged as HM Revenue & Customs (HMRC) may decide not to accept your arrangement, and it could result in both you and your employees paying additional NICs and income tax. Contributions should therefore be taken from your employees' pay after tax has been deducted until the updated contract is in place.

There are a number of ways to update employment contracts - you can do this with:

- an agreement letter;
- a salary exchange opt-out form; or
- a new contract of employment.

If you need support with these documents you should consult an employment law specialist.

Agreement letter

The simplest way to update existing employment contracts is with an agreement letter, which can be used to exchange salary or contractual bonuses. You'll need separate agreement letters for each, and one for every employee.

Both you and your employee need to sign the letter and it should include:

- Employee's name.
- Salary or bonus details before and after the exchange.
- The date the exchange will take effect from and in what circumstances it will end.

Within the letter you can decide if you want to include details about how your employees can opt out of the agreement, and how and when they can end it. Regardless of whether you include this in the letter or not, you'll need to have a process in place to minimise opting in and out happening too frequently and the administration work that it would involve.

If an employee has previously opted out of the agreement and wants to opt back in at a later date, you can outline in the letter how they do this - for example, in writing or by email.

Salary exchange opt-out form

Alternatively, you can use a salary exchange opt-out form to record requests from employees who don't want to be included in the salary exchange arrangement. This should contain the same level of detail as an agreement letter.

Your employees can choose to opt in or opt out

Although you've chosen to offer salary exchange on your scheme, regardless of your scheme's default, your employees can still decide if they want to opt in or opt out of the salary exchange arrangement.

Some employees may have experienced a change in their personal circumstances, for example a divorce or change in their finances, and decided that they no longer want to be included in the salary exchange arrangement.

You'll need to make sure you've a clear process in place to deal with employees who opt in or out of the arrangement.

If they're opting out of the salary exchange arrangement but continuing to contribute to their pension, their pension contributions should continue but on the relief at source basis.

Be clear about what the arrangement includes

You can decide whether you want to let your employees exchange just their salaries, or whether you want to also give them the option to exchange any contractual bonuses you may award. It won't change how the scheme is set up, but you'll need to give your employees a separate letter for contractual bonuses.

Calculate salary exchange amounts

If your payroll doesn't support salary exchange calculations, you'll need to decide how these will be calculated and if additional resource will be required.

Once calculated, contributions should be submitted as an employer only contribution. This will ensure both you and your employee's benefit from the correct tax and NIC savings.

Update your employee payslips

Employee payslips can be updated to reflect a salary or bonus exchange contribution. This is one way to check that the arrangement details have been set up correctly.

Know your legal obligations

Before you set up a salary exchange arrangement, it's important to make sure you've got everything in place that's needed. This includes making changes to your employees' contracts of employment so they meet legal requirements. As this is a matter of employment law, you should speak to an employment law specialist.

The information in this guide is based on Royal London's understanding of current legislation and HMRC requirements, which could change in future.

You can find out more here:

National Minimum Wage

HMRC guidance: Salary sacrifice for employers

HMRC information on salary sacrifice

Supporting you along the way

Once you've completed all of these steps, we can help you get set up and engage your employees with your salary exchange scheme.

Setting up a new scheme with salary exchange

When setting up your new workplace pension scheme with Royal London, your dedicated implementation manager will work with you to add all employees who want to join, and record if they're joining on a salary exchange or relief at source basis.

Each scheme member will receive confirmation of what's being paid into their pension plan.

If you've chosen to have salary exchange as your scheme's default your implementation manager will ensure this is set up too.

You'll need to update your employee details each time there's a change in salary or circumstances. Your implementation manager will show you how to do this using our online service and give you all the training you need to make sure you're comfortable running the scheme yourself.

Adding salary exchange to an existing scheme

If you're looking to add salary exchange to your existing Royal London pension scheme, our Customer Service team can help. They'll need you to confirm:

- If your contribution structure will be the same for those on a salary exchange arrangement. And if different, what percentages should be applied.
- Which existing members, or categories are moving to salary exchange.
- If there are any Qualifying Earnings to be applied.
- If your NIC savings are being invested in your employees' pension plans or if you're keeping them to reinvest in your business.
- If employee NIC savings are being reinvested into the pension plan or added to their take home pay.
- If you're offering a salary exchange opt out consultation period and if so, what date will this expire.

Engage your employees

To help make sure your arrangement's a success you'll need to communicate salary exchange to your employees outlining the benefits and the considerations.

You can access ready-made communications and download them for free from our communications toolkit.

There's also a salary exchange calculator which you can use to create personalised illustrations for your employees - based on their individual circumstances. It shows how their pension contributions and take-home pay could change if they exchange part of their salary.

Ready to set up your arrangement?

The below checklist can help you record your progress when setting up your arrangement.

1. Check the level of support provided by payroll provider	☐
2. Decide if salary exchange will be set as default	☐
3. Consult an employment law specialist, if needed	☐
4. Understand changes that need to be made to employee contracts	☐
5. Decide which members salary exchange is being offered to	☐
6. Decide if you'll keep your employer NIC savings or reinvest in your employees pension plan	☐
7. Decide what percentage of your employer NIC savings will be reinvested (if applicable)	☐
8. Decide if you'll reinvest employees NIC savings or allow them to add to their take home pay.	☐
9. Decide if a minimum salary threshold will be set	☐
10. Update employee contracts, ensuring your salary exchange arrangement is outlined clearly	☐
11. Calculate salary exchange amounts	☐
12. Update employee payslips	☐

Need to know more?

For further information speak to your financial adviser

If you don't have a financial adviser there's a number of directories you can use to find one in your area.

Royal London
royallondon.com

We're happy to provide your documents in a different format, such as braille, large print or audio, just ask us when you get in touch.

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