[Category = Payroll and Pensions, Sub = Auto-enrolment]

The costs of auto-enrolment – more than just contributions

Paying contributions into employees’ pension pots is likely to be the biggest single cost burden as organisations comply with their auto-enrolment obligations, but employers should be ready for a range of other expenses.

In addition to the increased payroll costs of the pension contributions themselves, employers will need to budget for adapting payroll processes to support auto-enrolment, achieving and recording compliance with the new rules, communicating the new pension to staff, sourcing professional pensions advice on selecting the best scheme for the workforce and the management time needed to make it all happen.

The extent of these extra costs of auto-enrolment on employers will vary widely from organisation to organisation, depending on a number of factors. These include the profile of their workforce, the pension arrangements already in place and the quality and type of the payroll software the employer already has. Where employers already offer all or most employees a pension scheme of sufficient quality to meet the standards set by the new regulations, costs of complying with the new auto-enrolment regulations will be much lower than they will for those employers with large parts of their workforce currently not offered a pension.

Expenditure will also vary depending on the extent to which the employer wants to communicate the benefits of auto-enrolment to its employees. Some communications are obligatory, but if an employer is spending a significant amount on its auto-enrolment obligations anyway, it may want to spend a little more on communications to make sure employee engagement and goodwill are maximised. Clear communications to staff at the outset should also lead to fewer administrative queries from staff as auto-enrolment progresses.

The costs of auto-enrolment implementation can be significant for an organisation. Lloyds Banking Group is one of the few big employers to go public with an estimate of what its auto-enrolment implementation cost will be. It estimates around £1m will be spent on implementing auto-enrolment, excluding the cost of increased employer pension contributions, budgeting at a cost of around £10 for each of its 107,000 employees.

Payroll data configuration

Payroll data configuration costs will be arguably the biggest cost of auto-enrolment implementation, aside from employer pension contributions. A company’s pension provider or providers will expect to receive data from employers in a particular way. But an organisation’s existing payroll software may not already collate its data in the same way.

Most employers will therefore need some form of ‘middleware’ to get the data out of their payroll system and into the pension provider’s system in the way they are expecting to receive it. Middleware solutions may be offered by an employer’s existing payroll provider, the pension provider selected to run the auto-enrolment scheme or a third party provider. The cost of this middleware will depend on the size of the employer and the complexity of the task.

An employer may even find it is more cost effective to put in place a new payroll system than attempt to deal with an antiquated one.

Not all data will be correctly inputted in the first place, so there will be a need for data cleansing of the information sent to the pension provider, which the employer will have to pay for through their HR team. The cost of this to the employer will depend on the quality of the data it holds in the first place.

Compliance costs

The auto-enrolment legislation places a number of legal obligations on employers, including notices to employees, automatically enrolling them into schemes, deducting and paying contributions and managing opt outs and opt ins and refunds of contributions. Employers are also required to maintain records that they have complied with the regulations, and have these records available to the Pensions Regulator on request. There are strict penalties for non-compliance.

Most of the middleware solutions referred to under the previous section will manage and record compliance with these regulations. Pension consultancies and providers offer middleware that will deal with both compliance costs and payroll data configuration for a cost of around £7 to £8 per employee. This charge usually includes the cost of sending obligatory letters and notices about joining and opting out.

Communication

Communication is essential to a successful auto-enrolment implementation programme. Some communications, such as those concerning joining and opting out, are obligatory but an employer may want to pay for extra communications, depending on the type of workforce involved and the employer’s objectives. Where a generous scheme is already in place, communication costs will be lower than where large populations of employees are being offered pensions for the very first time.

If an employer has a paternalistic corporate philosophy and wants to achieve very low levels of opt-out from the scheme, it will need to spend more on communications than an organisation looking to do the very minimum to meet its auto-enrolment obligations.

Employers should be clear with their partners as to who is paying for which communications. Some pension providers may say they will ‘help’ employers with communications. But this will often extend no further than supplying them with text for employers to send letters to their employees. If this is the case, employers need to budget for the cost of printing and postage of the communications they want.

Normally an employer will want to warm up an employee about auto-enrolment three months or so before they are enrolled, as well as explaining the benefits of the pension in greater detail at the time of enrolment. These communications are not normally included in the cost of the pension itself.

Many communication messages can be sent electronically, which is much cheaper than paper-based communications. An employer’s ability to do this will depend on the extent to which it has the email addresses of all its employees.

Given that an employer is already likely to be spending a considerable amount of extra money on auto-enrolment through increased pension contributions to employees, it may wish to spend a little bit more on communicating the benefits of what it is doing for staff. Spending more on communications to properly engage staff with their pension and other benefits can pay returns to employers in terms of retention, motivation and loyalty of staff.

Advice

Employers with complex pension provision already in place or with varied workforces will need professional advice from a pensions consultant on how to meet their auto-enrolment obligations. A pension consultant will help an employer choose the most suitable pension for their objectives and ensure the employer gets the maximum value for the extra money it is spending.

For larger employers, advisory and consultancy costs can run into tens of thousands of pounds. Those employers with a mixture of defined benefit and defined contribution plans may find auto-enrolment advisory costs are even higher.

Smaller employers with uniform workforces and who have little interest in engaging employees with auto-enrolment may be able to get away without paying for advice by going direct to the National Employment Savings Trust [link: <http://www.nestpensions.org.uk>] , which has a statutory duty to offer a pension scheme to any employer, or to one of the other master-trust pension providers targeting employers direct.

Paying for advice and communications – the abolition of commission

In the past many of the communication programmes offered through company pension schemes have been delivered by corporate financial advisers and pension consultants at no apparent cost to the employer. While some employers have paid adviser and consultant costs directly themselves through a fee, other employers have not had to pay up front for these services because the adviser or consultant has been paid commission by the pension provider. Where advisers have received commission, employees have effectively borne some of the costs of communication programmes through the deduction of annual management charges from their pension pots.

Since 31 December 2012, it has been illegal to set up new group pension schemes on a commission basis, following the implementation of the Financial Services Authority’s Retail Distribution Review. This means an employer putting in place a new workplace pension scheme today cannot receive ‘free’ advice or communications programmes paid for out of commission paid to advisers and consultants. Existing schemes set up on a commission basis can continue however, meaning new joiners will be able to receive communications and possibly advice from pension advisers or consultants at no extra cost to the employer.

Where new schemes are set up now, employers will either have to pay for communications and advice through a fee, or through a controversial new method of adviser remuneration called consultancy charging which carries some of the features of the old commission system.

Under consultancy charging, a corporate pensions adviser agrees with the employer the level of charges for the services that are to be delivered, whether on advice on the scheme itself or for communications and member engagement programmes. The employer then agrees with the adviser how these are to be paid, with the most common structures being a percentage of the employer and/or employee contributions into the pension for a fixed period.

Research of independent financial advisers carried out by NMG in September 2012 found the average consultancy charge per scheme member was £78, with charges ranging from £40 to £150 per member.

However, the Government and regulators are concerned that consultancy charges could seriously erode employees’ auto-enrolment pots and the Department for Work and Pensions is currently reviewing industry practice in the area, with one option on the table an outright ban of the practice. This means few employers are opting for consultancy charging structures at the present time.

John Greenwood

Next month’s article on auto-enrolment will look at who is considered to be an eligible worker for auto-enrolment purposes and will be available from April 2 2013.