

# Employee benefits, pensions and allowances

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## EMPLOYEE BENEFITS

### *Definition*

Employee benefits are elements of remuneration given in addition to the various forms of cash pay. They also include items that are not strictly remuneration, such as annual holidays.

### *Objectives*

The objectives of the employee benefits policies and practices of an organization are to:

- provide an attractive and competitive total remuneration package which both attracts and retains high-quality employees;
- provide for the personal needs of employees;
- increase the commitment of employees to the organization;
- provide for some people a tax-efficient method of remuneration.

Note that these objectives do not include 'to motivate employees'. This is because the

normal benefits provided by a business seldom make a direct and immediate impact on performance. They can, however, create more favourable attitudes towards the business which can improve commitment and organizational performance in the longer term.

### *Main types of employee benefits*

Benefits can be divided into the following categories:

- *Pension schemes*: these are generally regarded as the most important employee benefit.
- *Personal security*: these are benefits which enhance the individual's personal and family security with regard to illness, health, accident or life insurance.
- *Financial assistance*: loans, house purchase schemes, relocation assistance and discounts on company goods or services.
- *Personal needs*: entitlements which recognize the interface between work and domestic needs or responsibilities, eg holidays and other forms of leave, child care, career breaks, retirement counselling, financial counselling and personal counselling in times of crisis, fitness and recreational facilities.
- *Company cars and petrol*: still a much appreciated benefit in spite of the fact that cars are now more heavily taxed.
- *Other benefits*: which improve the standard of living of employees such as subsidized meals, clothing allowances, refund of telephone costs, mobile phones (as a 'perk' rather than a necessity) and credit card facilities.
- *Intangible benefits*: characteristics of the organization which contribute to the quality of working life and make it an attractive and worthwhile place in which to be employed.

### *Taxation*

It should be remembered that most benefits are taxable as 'benefits in kind', the notable exceptions being approved pension schemes, meals where these are generally available to employees, car parking spaces, professional subscriptions and accommodation where this is used solely for performing the duties of the job.

### *Flexible benefits*

Flexible benefit schemes (sometimes called cafeteria schemes) allow employees to decide, within certain limits, on the make-up of their benefits package. Schemes can allow for a choice within benefits or a choice between benefits. Employees are

allocated an individual allowance to spend on benefits. This allowance can be used to switch between benefits, to choose new ones or to alter the rate of cover within existing benefits. Some core benefits such as sick pay may lie outside the scheme and cannot be 'flexed'. Employees can shift the balance of their total reward package between pay and benefits, either adding to their benefits allowance by sacrificing salary or taking any unspent benefit allowance as cash.

Flexible benefit schemes provide employees with a degree of choice on what benefits they want, according to their needs. A flexible benefit policy can save employers money on benefits that are neither wanted nor needed.

### *Total remuneration*

The concept of total remuneration is based on the principle of treating all aspects of pay and benefits provision as a whole. The cost to the business and the value to the individual of each element can be assessed with the object of adjusting the package according to organizational and individual needs. Consideration can also be given to the overall competitiveness of the total package in the market place.

## OCCUPATIONAL PENSION SCHEMES

The reasons for having a worthwhile pension scheme are that it:

- demonstrates that the organization is a good employer;
- attracts and retains high-quality people by helping to maintain competitive levels of total remuneration;
- indicates that the organization is concerned about the long-term interests of its employees.

### *Definition*

An occupational pension scheme is an arrangement under which an employer provides pensions for employees when they retire, income for the families of members who die, and deferred benefits to members who leave. A 'group scheme' is the typical scheme which provides for a number of employees.

### *Operation*

Occupational pension schemes are administered by trusts which are supposed to be

outside the employer's control. The trustees are responsible for the pension fund from which pension benefits are paid.

The pension fund is fed by contributions from employers and usually (but not always) employees. The size of the fund and its capacity to meet future commitments depend both on the size of contributions and on the income the trustees can generate. They do this by investing fund money with the help of advisers in stocks, shares and other securities, or through an insurance company. In the latter case, insurance companies offer either a *managed fund* – a pool of money managed by the insurance company for a number of clients – or a *segregated fund* which is managed for a single client.

### *Contributions*

In a *contributory scheme* employees as well as employers make contributions to the pension fund. Pensionable earnings are total earnings from which may be excluded such payments as overtime or special bonuses. A sum equal to the State flat rate pension may also be excluded.

The level of contributions varies considerably, although in a typical contributory scheme, employees would be likely to contribute about 5 per cent of their earnings and employers would contribute approximately twice that amount.

### *Approved scheme*

Members of an occupational scheme that has been approved by the Inland Revenue (an *approved scheme*) obtain full tax relief on their contributions. The company also recovers tax on its contributions and the income tax deductible from gains realized on UK investments. This makes a pension fund the most tax-efficient form of saving available in the UK.

Employers can establish unapproved pension schemes which provide benefits in excess of approved schemes but at the expense of the generous tax allowances for the latter type of scheme.

### *Retiring age and sex discrimination*

Traditionally, the retiring age was 65 for men and 60 for women. However, under the Sex Discrimination Act (1986), it is unlawful for employers to require female employees to retire at an earlier age than male employees. In its judgement on the *Barber v Guardian Royal Exchange* case on 17 May 1990 the European Court ruled that pension was 'pay' under Article 119 of the Treaty of Rome (which provided for equal pay) and that it was unlawful to discriminate between men and women with regard

to pension rights. It has since been agreed that pensions would not be considered as pay prior to 17 May 1990.

### *Benefits statements*

Every member of an occupational scheme is entitled to an annual statement setting out his or her prospective benefits.

### *Types of occupational pension schemes*

A defined benefit or *final salary* group pension scheme offers a guaranteed pension, part of which may be surrendered for a tax-free cash sum. In its final pay or salary form, the pension is a fraction of final pensionable earnings for each year of service (typically 1/60th). To achieve the maximum two-thirds pension in a 1/60th scheme would therefore take 40 years' service. Defined benefit schemes provide employers with a predictable level of pension. But for employers, they can be costly and unpredictable because they have to contribute whatever is necessary to buy the promised benefits.

In a defined contribution or *money purchase* scheme employers fix the contributions they want to pay for employees by undertaking to pay a defined percentage of earnings irrespective of the benefits available on retirement. The retirement pension is therefore whatever annual payment can be purchased with the money accumulated in the fund for a member.

A defined contribution scheme offers the employee unpredictable benefits because these depend on the total value of the contributions invested, the investment returns achieved and the rate at which the accumulated fund can be converted into pension on retirement. For the employer, however, it offers certainty of costs.

### *Stakeholder pensions*

All employers with five or more people on their payroll are obliged to provide access to a stakeholder pension for employees who have no access to a company pension. Stakeholder pensions will be money-purchase schemes and, initially, employers do not have to make a contribution and employees are not required to take them out (although these conditions may be changed). Employers can designate a stakeholder scheme from a provider but in choosing one are required to consult with the employees concerned.

### *Developments in pension provision*

As the CIPD (2003b) comments:

The last decade has seen a significant change in the nature of occupational schemes offered to new employees. There has been a shift away from defined benefit schemes for new employees in favour of defined contribution schemes. There has also been a significant growth in mixed and hybrid types of pension plan, and a reduction in the proportion of the total workforce who are members of occupational schemes of any type.

The move away from defined benefit (final salary) schemes has largely been because of the increasing and unpredictable costs of such schemes. But as the CIPD states, 'An important driver of these changes has been demographic, with a declining birth rate and fall in the average retirement age, combining with the significant increase in life expectancy to push up scheme costs. Greater labour market flexibility may also be a contributory factor.' Some organizations such as the civil service are introducing money purchase schemes to help to recruit and retain younger employees in specialist fields.

### *The contribution of HR*

As suggested by the CIPD, HR can contribute to the development of pensions policy by:

- defining and communicating clear pension goals aligned to the needs of the organization and its staff;
- advising on the design and implementation of appropriate schemes to achieve these goals – flexibility and choice on provision are important components of these designs to meet the needs of a more diverse workforce;
- educating managers and employees so that they can take on personal responsibility and make informed choices on the way they want to work and move into retirement, with the appropriate pension provision to achieve this.

## ALLOWANCES AND OTHER PAYMENTS TO EMPLOYEES

The main areas in which allowances and other special payments may be made to employees are:

- *Location allowances* – London and large town allowances may be paid because of housing and other cost-of-living differentials. Allowances are paid as an addition to basic pay although many employers in effect consolidate them by paying the local market rate which takes into account explicit or implicit location allowances and costs.
- *Subsistence allowances* – the value of subsistence allowances for accommodation and meals varies greatly between organizations. Some have set rates depending on location or the grade of employee. Others allow ‘reasonable’ rates without any set scale but usually, and desirably, with guidelines on acceptable hotel and meal costs.
- *Overtime payments* – most manual workers are eligible for paid overtime as well as many staff employees up to management level. Higher-paid staff may receive time off in lieu if they work longer hours. Typically organizations that make overtime payments give time and a half as an overtime premium from Monday to Saturday, with double time paid on Sundays and statutory holidays. Some firms also pay double time from around noon on Saturday. Work on major statutory holidays such as Christmas Day and Good Friday often attracts higher overtime premiums.
- *Shift payments* are made at rates which usually vary according to the shift arrangement. A premium of, say, one-third of basic pay may be given to people working nights while those on an early or late day shift may receive less, a premium, say, of one-fifth of basic pay.
- *Stand-by and call-out allowances* may be made to those who have to be available to come in to work when required. The allowance may be made as a standard payment added to basic pay. Alternatively, special payments may be made for unforeseen call-outs.