Advice for small business owners

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There are undoubtedly many concerns for small business owners in the current economic climate. In this document we identify two areas where a good financial advisor can certainly help. Firstly ensuring you understand your options with regards to new pension legislation. And secondly that you are able to limit the negative impact on your business of losing any business critical employees.

In this brief ...

1. Understanding the basics

Types of pensions and how they work

There are 3 categories of occupational pensions:

1. Defined Benefits	2. Defined Contribution	3. Hybrid
Defined benefit is a pension scheme where the pay-out is based on an employee's salary and length of service.	A defined contribution scheme is built up through contributions from both the employer and the employee. The final fund however, is dependent on how much is contributed and on the stock market performance of their investment choices.	A hybrid scheme is a scheme that is a combination of a defined benefit and defined contribution scheme.
Final Salary Schemes are an example of this. Employers now prefer to offer defined contribution schemes which carry less risk for the employer, and are cheaper to run.	Money purchase, group personal pensions (GPPs) and stakeholder pensions are all defined contribution plans.	Perhaps the most common hybrid is the "nursery scheme". You are provided with money purchase benefits until you reach a given age, e.g. 40, at which point you become eligible to earn final salary benefits. Employers share some of the risk.

Lets look at some of the most common Defined Contribution Schemes:

Group Personal Pension Scheme

As an employer you make an arrangement with a pension provider or financial advisor to offer personal pensions to a group of employees. Each employee has a separate contract with the pension provider or advisor, but the contributions are collected by the employer through payroll. The employee makes their own investment selection from the choice of funds offered by the pension provider or advisor. Note some GPP schemes are compliant with auto enrolment rules.

Stakeholder Pension Scheme

A stakeholder scheme is a low charge, contract-based (with the employee), defined contribution pension. As well as a cap on charges, stakeholder schemes must accept a minimum contribution of just £20. Employees can stop, start, raise or lower their contributions in this type of scheme without penalty. The employee makes their own investment selection from the choice offered by the pension provider or advisor. Employees must be consulted about the company's choice of designated scheme and employers must make payroll deductions of pension contributions for those employees wanting to pay into the scheme. Employers don't set up the stakeholder pension scheme - the scheme provider does that. Not all stakeholder pensions meet auto enrolment requirements.

Money Purchase Scheme

A money purchase scheme is a trust-based defined contribution scheme. The size of the employee's pension is determined by the size of the contributions to their pension, the performance of the investments in the scheme and the cost of an annuity (annuity rate) when they retire. Objectives are set out in the trust deed and day-to-day decisions are made by the trustees. Employers still have some key responsibilities, either as employers or as trustees - for example, on the level of employer contribution, or the extent of provision for dependants. Once the employee leaves payments cease.

Self Investment Pension Plans (SIPPs)

New pension rules which give you far greater flexibility over what you can do with your pension pot came into force on 6 April 2015. This includes being able to access your entire SIPP and choosing how to take your income during your retirement.

A SIPP allows regular and lump sum cash payments, and employees are able to transfer other pension arrangements into the scheme. SIPPs allow investments from a wide range of sources: commercial property, shares and unit trusts. Employers may pay into a SIPP and a Group SIPP behaves similarly to a Group Personal Pension and has the potential to more closely match the needs of the employee over time. It will be important to discuss the level of flexibility and how to keep charges to a minimum with your advisor.

A Brief Reference To Salary Sacrifice

Salary Sacrifice is offered by some employers as a means for their employees to receive increased pension scheme contributions. The sacrificed part of their salary is paid into their pension plan directly by the employer, rather than being paid by the employee. As a result of you having a lower salary, the employee and employer pay less National Insurance Contribution (NIC). As part of the salary sacrifice deal, the employers may choose to pay part of the NIC saving to the pension plan along with the sacrificed amount. Note there are advantages and disadvantages to employees so advice should be taken. For further information see Salary Sacrifice Advice.

Employer pension duties

The auto-enrolment obligations are being phased in all the way up to 2018, the actual enrolment date (staging date) is based on company size. Every employer regardless of size will need to automatically enrol eligible jobholders into a qualifying pension scheme and contribute to that scheme at some point.

Employers:

12-9 months before staging

1. Know when you need to be ready
2. Provide a point of contact
3. Develop your initial plans

9-0 months before staging

1. Find out who to enrol
2. Choose your software and check records
3. Choose a pension scheme

Staging date

Employers must contact their employees within 6 weeks of the staging date

1. Automatically enrol your staff
2. Tell your staff
3. Maintain records
4. Fulfill ongoing responsibilities

Employees fall into 3 categories:

1. Eligible jobholders:

Will automatically be enrolled in to their workplace pension scheme:

Age 22– State Pension Age (SPA)

Earning £10,000 pa +

2. Non-eligible jobholders

Will not be automatically enrolled but can ask to join.

Age 16 –21

SPA—74

Earning £10,000 pa +

3. Entitled workers

Will not be automatically enrolled but can apply to join. Employers are not obliged to contribute.

All employees earning £5,824 or less

To find out your staging date and for a step by step guide use this link to the Pension Regulators guides and tools on the subject. Your Bridge Advisor can also help you understand the decisions or changes you are required to make.

Eligible schemes:

It may be possible to adapt existing schemes to meet the legal requirements. The scheme types mentioned earlier Defined Benefit, Contribution and Hybrid all qualify. Group Personal Pension Schemes and Stakeholder Pension Arrangements, Final Salary and Occupational Money Purchase Schemes can all meet the criteria. The Government has also sponsored the creation of a new pension scheme (NEST) designed to meet the needs of small employers and low earners. NEST is not regulated by the Financial Conduct Authority but is regulated by the Pensions Regulator.

All schemes must be UK based or administered in the European Economic Area. What is important here is the rules around automatic enrolment, barriers to scheme entry and employer contribution. The legislation still allows for Salary Sacrifice.

Business Protection Insurance - Key person (keyman) insurance

Keyman insurance is policy designed to pay out an agreed cash sum if a key employee suddenly stops work due to death or a critical illness. That person will be “business critical” – it could be the managing director, a senior finance or sales director or perhaps the head of development – fundamentally a person who is seen as a significant revenue generator or business figurehead. Unlike personal insurance, the payment is a specified sum made to the business. It allows a company to shore up profits, to buy the deceased’s shares, perhaps repay company debts or cover recruitment costs. In essence it is an insurance that is often overlooked but represents extremely good planning for small businesses, if the business owners are able to set aside funds. There are 3 types of policies:

1. Profit protection - uses include shoring up profits, training and recruitment.
2. Corporate loan and overdraft protection - a cash sum for repaying company debt, especially useful if the directors have personal guarantees or second mortgages in place.
3. Ownership Protection - used to buy out the deceased (or critically ill) director's or partner's shareholding

Bridge Investments can help you in deciding if such cover is advisable, the level of cover required and the affordability to the business. It also goes without saying that for small business owners, personal medical insurance and income replacement plans should also be discussed with your Financial Advisor.

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2. Our tips on best practice

Benefit not burden

While it is easy to say, and there are undoubtedly for many small businesses, significant costs associated with new pension legislation compliance and any business protection schemes, understanding the costs, taking advice early, and then making informed choices on how best to proceed, has the potential to both reduce those costs as well as giving greater peace of mind.

Again easy to say, but as occupational employer supported pensions move from being an employee benefit to an employee right, ensuring that employees have a pension scheme which meets their individual needs and also fits with what the business can afford to support, can still be translated into an employee benefit.

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3. How Bridge Investment can help

What Bridge Investments do

We are able to offer a full review of your pension, business protection and any employee benefit requirements. We can set up and administer schemes for you. We will provide your business and employees with regular financial reviews (and presentations if required) and make sure you are fully abreast of all legislation that affects your business. We pride ourselves on a truly personal service.