Advanced payment of pension contributions by employers

Contents

1. Introduction

Employers are responsible for paying both employer and employee contributions to the Fund.

Employer contributions are made up of two elements; primary contributions and secondary contributions. Primary contributions are certified by the Actuary as a percentage of pensionable pay and are the amount required to pay for benefits being built up by employees who are currently paying into the scheme. Secondary contributions are amounts certified in addition to the primary contributions and are usually related to the recovery of a pension deficit. Secondary contributions are usually certified as a monetary amount.

Employee contributions are deducted by employers and paid over to the Fund by 22nd of the month following deduction. Contribution rates for employees are set at for the LGPS as a whole rather than by an individual fund, although it is an employer responsibility to correctly assess the contribution band for their employees.

The Administering Authority will allow any employer apart from those in the Academies Group to pre-pay secondary contributions[1]. In addition, any employer who is not part of a group can choose to pre-pay their primary contributions. An employer who chooses to

[1] Employers in the Academies Group pay a common primary contribution rate and a share of the Group's deficit based on their proportion of the Group's liabilities. No discount can therefore be attributed to an individual employer within the Academies Group.

pre-pay their primary contributions must also pre-pay their secondary contributions.

The Administering Authority will allow any employer who chooses to pre-pay primary and secondary contributions to also pre-pay an amount equal to an estimate of employee contributions.

2. Options for pre-payments

The three options for pre-payment are:

Option 1 – Secondary contributions only

Option 2 – All employer contributions (primary and secondary)

Option 3 – All employer contributions and an amount equal to estimated employee contributions

The three options for pre-payment each have two sub options:

- payment annually in advance on 1 April each year, or
- payment triennially in advance (i.e. one payment on the 1 April for all three years).

A decision to pay triennially in advance must be made by 31 January following the valuation date i.e. 31 January 2023 for the 2022 valuation.

If an employer is electing to pre-pay annually, they can make a separate decision for each year as long as the election is made by 31 January, for the following year beginning 1 April.

Pre-payments will receive a discount if the employer meets the following conditions:

- notify the Administering Authority of their intention to pre-pay by 31 January
- pay the full amount of their advanced payment to the Pension Fund's bank account on 1 April*
- if paying primary contributions in advance, include actual pensionable pay on each monthly remittance form
- if paying an amount equal to estimated employee contributions in advance, include the actual employee contributions deducted on each monthly remittance form.

* Please note that if 1 April is a non working day, the payment will be due on the following working day i.e. for 2023 the payment is due on Monday 3 April 2023.

3. Discounts applied

The Fund's Actuary has confirmed that the discount for employer contributions paid in advance for the triennial valuation period 2023/24 to 2025/26 is based on the discount rate for the secure scheduled bodies group.

Employers who are pre-paying employer and an amount equal to estimated employee contributions will receive a greater discount on the payment, calculated using the following formula:

Discount factor - ((Assumed employee contribution rate/Employer rate) x (1 – discount factor))

The actual discount rate will vary by employer, depending on their certified employer contribution rate and assumed average employee contribution rate.

No discount is actually applied to employee contributions which must be paid over to the Fund without reduction. To compensate for early payment of an amount equal to the estimated employee contributions an additional 'discount' is added to Employer discount. This is equivalent to a 2.1% discount rate as if applied to the employee contributions.

The table below shows the discount rates applicable to 1 and 3 year payments.

	1-year advanced payment	3-year advanced payment		
	Year 1 discount	Year 1 discount	Year 2 discount	Year 3 discount
Pre-payment of employer contributions only	2.1% (amount due x0.979)	2.1% (amount due x0.979)	6.3% (amount due x0.937)	10.2% (amount due x0.898)
Pre-payment of employer contributions and an amount equal to estimated employee contributions	0.979 – (assumed employee contribution rate / employer contribution rate) x 0.021 -	0.979 – (assumed employee contribution rate / employer contribution rate) x 0.021	0.937 – (assumed employee contribution rate / employer contribution rate) x 0.063 -	0.898 – (assumed employee contribution rate / employer contribution rate) x 0.102 -

4. Pre-payment of secondary contributions – amount to pay

The Fund's Actuary will certify annual amounts of secondary contributions due for each of the years covered by the Rates and Adjustments certificate. An employer can choose to pay the total amount certified for the three years as a one-off payment on 1 April 2023, or each annual amount on 1 April each year.

5. Pre-payment of primary contributions – estimated annual pensionable payroll

Primary contributions are certified as a percentage of pensionable pay. Therefore if an employer chooses to pay primary contributions in advance, an estimated payroll figure needs to be used to calculate the amount of the pre-payment. The estimated 2023/24 pensionable pay will be based on a roll forward of the 2021/22 actual pensionable payroll provided in the annual return. The roll forward will use the Fund Actuary's observed pay growth of 3.25% pa from the 2022 Valuation (applied twice, once for 2022/23 pay and again for 2023/24 pay).

If the employer believes that this approach will result in a materially different figure for

2023/24 pensionable pay to their own estimate, they should raise this with the Administering Authority before 31 January to agree a different figure. The Administering Authority reserves the right to specify the amount of estimated pensionable pay on which advanced contributions payments are made.

6. Pre-payment of primary contributions - 'True-up' arrangements

Following the end of each financial year the Administering Authority will 'true-up' the primary employer pension contributions due (less the discount applied) based on actual pensionable pay against the payment made in advance, to ensure that the employer has paid the correct amount of contributions. The Administering Authority will provide the calculation of the employer's 'true-up' within 10 working days of receipt of the employer's March remittance of pensionable pay.

If the amount of contributions paid in advance are greater than the actual contributions due (i.e. the employer has paid too much) they will not be issued a refund. The amount of overpayment will count towards the total assets the Pension Fund has accumulated for the employer that the Fund's Actuary will use to calculate the employer's funding level and future contributions for the next Actuarial Valuation.

If the amount of contributions paid in advance are less than the actual contributions due (i.e. the employer has paid too little) the employer will need to make an additional contribution. The amount of additional contribution will be subject to an interest charge at the 1 year discount rate (2.1%) to reflect that the Pension Fund has not received a return on the shortfall of contributions in that year. Any additional contribution necessary after the 'true-up' will be due within 14 days following the Administering Authority sending the employer their 'true-up' calculation.

Example 1 - Contributions paid annually in advance	
2021/22 pensionable payroll	£10,000,000
Up-lift to 2023/24 pensionable payroll (x3.25% x3.25%)	£10,660,563
Primary contribution rate (18.5%)	£1,972,204
Application of year 1 discount (x0.979)	**£1,930,788**
'True-up'	
Actual 2023/24 pensionable pay	£10,900,000
Primary contribution rate (18.5%)	£2,016,500
Less credit for undiscounted value of contribution paid	£1,972,204
Underpayment (+ve)/overpayment (-ve)	£44,296
Underpayment due from employer, plus interest (+2.1%)	**£45,226**
Total employer contributions due	**£2,016,500**
Total employer contributions paid (advance plus true up)	**£1,976,014**
Total saving to employer	**£40,486**

7. Pre-payment of an additional amount equal to estimated employee contributions – calculated of estimated employee contributions

An estimated employee contribution rate will be calculated for each employer using the data on the previous year's annual return (i.e. 2021/22 for the year 1 payment). The estimate will be calculated by dividing the main section employee contributions by the main section pensionable pay from the return.

If the employer believes that this approach will result in a materially different figure to their own estimate, they should raise this with the Administering Authority before 31 January to agree a different figure. The Administering Authority reserves the right to specify the estimated employee contribution rate to be used in the calculation of the additional discount.

8. Pre-payment of an additional amount equal to estimated employee contributions – monthly payment process

An employer who has pre-paid an amount equal to estimated employee contributions should continue to deduct the correct amount of employee contributions from their pay. However 1/12th of the pre-paid amount equal to the estimated employee contributions for that year due should be deducted from the actual contributions deducted before payment is made over to the Fund. The net payment should be made by 22nd of the month following deduction. The detail of the payment needs to be shown clearly on the monthly contribution remittance form.

If there is no payment due (i.e. that 1/12th of the estimated annual amount is greater than the amount of employee contributions deducted in that period), the contribution remittance form should still be provided to the Fund but no payment will be due that month. No refund will be provided to the employer.

9. Risk of poor investment returns

Whilst pre-payment allows a possible short term saving over the period of the Rates and Adjustments certificate, it could ultimately lead to higher employer contributions overall if the actual return achieved on the pre-paid contributions is lower than the assumed discount rate. Slide 108 from the 2022 AEM slides, which are available on our website, contain an illustration of a pre-payment decision resulting in a loss to the employer. Please ensure you are aware of this risk before making your decision on pre-payment.

10. Making your pre-payment election

Please email pensions.finance@hants.gov.uk by 31 January to let us know that you wish to take up the pre-payment option and confirm whether this is in relation to primary and/or secondary contributions and whether it is for a triennial payment for the period 2023/24 to 2025/26 or an annual payment for 2023/24.

Pension Services will issue a pre-payment calculation to you by 28 February which will show the employer contribution due on 1 April.

You will be sent a standard remittance form by 31 March for completion of your monthly employee contribution payments, and notification of actual pensionable pay (if paying primary or employee contributions in advance).

11. Further example

The example below shows the calculation for an employer who has chosen to pay employer and employee contributions triennially in advance.

Example 2 – Employer and Employee contributions paid triennially in advance			
2021/22 pensionable payroll	£10,000,000		
Up-lift to 2023/24 pensionable payroll (x3.25% x3.25%)	£10,660,563		
	2023/24	**2024/25**	**2025/26**
Estimated pensionable payroll (x3.3% each year 2024/25 onwards – 2022 valuation assumption)	£10,660,563	£11,012,361	£11,375,769
Primary contribution rate certified by Actuary	18.50%	18.50%	18.50%
Primary contributions due (pensionable payroll x 18.5%)	£1,972,204	£2,037,287	£2,104,517
Assumed average employee contribution rate	6.50%	6.50%	6.50%
Discount rate	0.972	0.915	0.862
Discounted primary contributions	£1,916,982	£1,864,117	£1,814,094
Estimated employee contributions	£692,937	£715,803	£739,425
	a	b	c
Total employer and employee contributions	£2,609,919	£2,579,921	£2,553,519
Triennial discounted contribution (a+b+c) due on 1 April	**£7,743,359**		
Monthly 'true-up' of employee contributions	**Jul-23**	**Sep-24**	**Feb-26**
Actual pensionable pay for the month	£891,667	£950,000	£958,333
Actual employee contributions deducted in the month	£57,513	£61,845	£62,292
1/12th of amount equal to estimated employee contributions pre paid	£57,745	£59,650	£61,619
Net payment due to Fund by 22nd of month following deduction	**£0**	**£2,195**	**£673**
Annual 'True-up' of employer contributions			
Actual pensionable pay	£10,700,000	£10,900,000	£11,500,000
Primary contribution rate (18.5%)	£1,979,500	£2,016,500	£2,127,500
Less credit for undiscount value of contribution paid	£1,972,204	£2,037,287	£2,104,517
Underpayment (+ve)/overpayment (-ve)	£7,296	-£20,787	£22,983
Underpayment due from employer, plus interest (+2.1%)	**£7,449**	**£0**	**£23,465**

*not refunded to the employer, retained by the Pension Fund and credited to the employer's funding level and future contribution rate at the next Actuarial Valuation