The issues revisited – Barriers to employee benefit success

Variability in salary inflation

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FROM EMPLOYEE BENEFITS SYSTEM

In *Benefits Barometer 2013*: The employee benefits system, we addressed the effect of high salary inflation and salary increases that are well above official consumer price inflation. We found that over the previous two years, real salary increases were above 9% for younger members. Salary increases raise an employee's standard of living, but often translate into increased borrowing and consumption rather than savings.

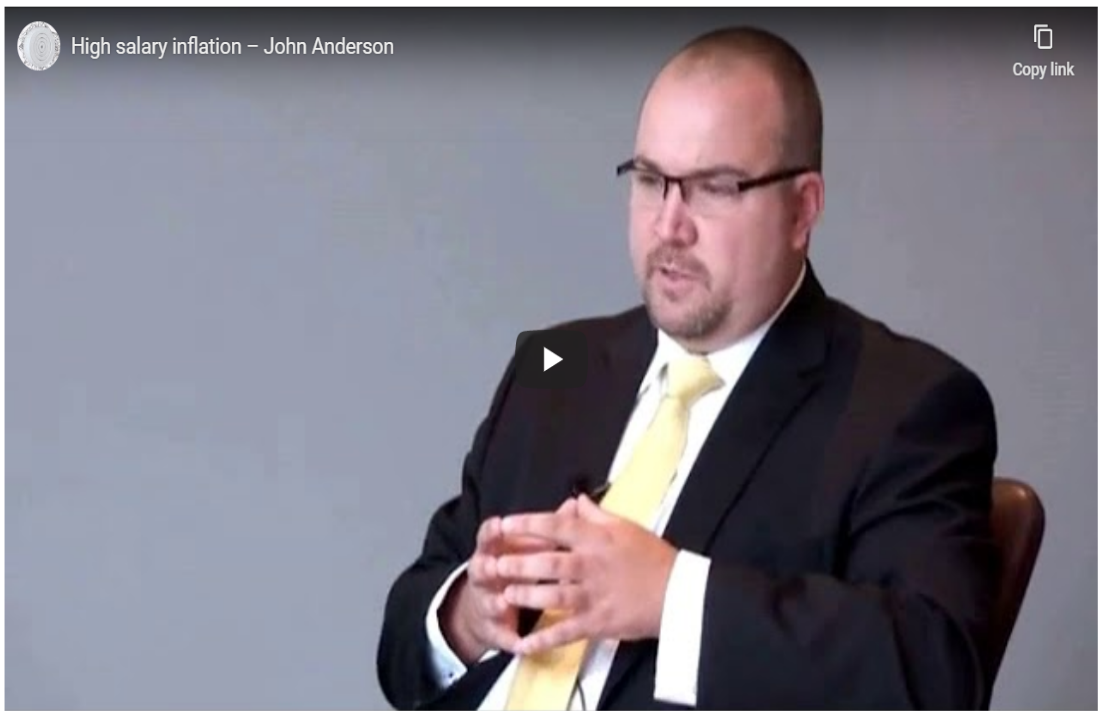
The result is that retirement savings do not keep pace with lifestyles. But the real problem of high salary inflation is that it may well exceed the assumed rate used to calculate projections of replacement ratios. Unless members adjust their contribution rates or benefit expectations, there is likely to be a shortfall at retirement.

New insights

In Benefits Barometer 2014: Fine-tuning the employee benefits system, we extend this section to take account of variable salary levels, that is, inconsistent pay from one year to the next. Volatile pay levels may affect commission earners, those employed in the service industry, real estate agents and individuals remunerated for services provided, like electricians. Even those who are formally and permanently employed may experience variable levels of pay.

Employees who earn volatile levels of pay may receive a guaranteed minimum monthly income or 'basic', while commission and other incentives are additional items of pay. When it comes to employee benefits, some employers may set the pensionable salary so it excludes the variable portion of income or is equal to the basic pay. In this way the cost does not have a negative effect on an individual's take-home pay. Some employers may even opt to set the pensionable salary at a lower level than basic pay. Where risk benefits and retirement fund contributions are based on this salary, employers need to note that this will usually result in inadequate protection for members and insufficient savings at retirement.

One way around this is for an employer to base risk benefits and retirement fund contributions on a notional fund salary. They can use the average total earnings over the last twelve months to calculate this salary. Employers could also set the pensionable salary percentage at 125% or 150% of an employee's basic earnings. This will ensure that employees maintain appropriate targets throughout the course of the savings programme.



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