

Pension aspects of the Coronavirus Job Retention Scheme: what employers and trustees should know

14 May 2020

Pension briefing

HIGHLIGHTS

The government's Coronavirus Job Retention Scheme (CJRS) has thrown a lifeline to many employers and to their employees who might otherwise have lost their jobs in the current Covid-19 crisis. For employers taking advantage of the CJRS (and the trustees of an employer's pension scheme), the scheme gives rise to several pensions-related issues, in particular:

- how pension contributions should be calculated;
- dealing with salary sacrifice arrangements;
- reducing contributions to the auto-enrolment minimum;
- auto-enrolment duties in respect of furloughed employees;
- the impact on benefits from open defined benefit (DB) schemes;
- the position of furloughed trustees; and
- life assurance benefits.

This note sets out our current understanding of how these issues may be addressed, based on the recently issued Direction from HM Treasury and updated guidance from HMRC and the Pensions Regulator.

Partial return to work

This note is based on the position at 14 May 2020, with furloughed employees prohibited from carrying out any work for their employer. The Chancellor announced on 12 May that from 1 August this year furloughed workers will be able to return to work part-time, with their pay funded partly by the furlough scheme and partly by their employer. No details are yet available but the changed arrangements are likely to cause further issues relating to those employees' pension arrangements. We will update this note as further information becomes known.



SALARY AND PENSION BENEFITS WHILE FURLOUGHED UNDER THE CJRS

- During the furlough period the employer should operate payroll and deduct PAYE and National Insurance Contributions (NICs) in the usual way.
- Employers may decide to make good the shortfall between CJRS compensation and the employee's regular pay and pension contributions, but are not obliged to do so (subject to any obligation in the employment contract or scheme rules).

Reminder: what is the CJRS?

- Under the CJRS, HMRC will pay employers of furloughed employees a grant worth 80% of the usual wage costs, up to £2,500 per month, plus the associated employer (NICs) and the minimum employer auto-enrolment contributions on the CJRS compensation.
- The scheme started with effect from 1 March 2020. On 12 May the Chancellor announced the extension of the scheme to 31 October 2020, with provisions to allow partial return to work from 1 August 2020.
- The furlough period must last for at least three weeks.

PENSION CONTRIBUTIONS WHILE ON FURLOUGH

- In most cases, employer and employee contributions should be calculated by reference to the pay actually received during the furlough period. However, requirements under the particular scheme rules and in the employment contract (if specified) should be checked. The situation is more complicated in the case of salary sacrifice arrangements – please see below.
- In relation to auto-enrolment (AE):
 - the CJRS will reimburse employers the minimum employer AE contributions for their furloughed workers: 3% of the employee's "qualifying earnings" (monthly earnings between £520 and £4,167) but capped at the level of the employee's CJRS compensation;
 - the same calculation of AE minimum contributions will be used for all employers, regardless of the level of pension contributions or the type of benefit paid under the employer's scheme; but
 - where the employer does not contribute at least 3% of qualifying earnings in respect of the employee (for example, because the employee has opted out of AE or has opted to contribute at a lower rate), the employer may only claim for any contributions it actually pays.
- Employers who pay more than the AE minimum will not have the excess contributions refunded. This includes excess over the AE minimum arising from:
 - contributions to an open defined benefit (DB) scheme
 - contributions higher than 3% to a defined contribution (DC) scheme;
 - contributions to a DC scheme calculated on all earnings (not just on AE qualifying earnings);
 - contributions where the employer chooses to pay the employee more than 80% of salary or £2,500 per month; and
 - contributions to a scheme where member contributions are paid by the employer via a salary sacrifice arrangement (please see below).
- Employers who calculate AE contributions to a DC scheme using one of the alternative permitted bases should continue to do this but in addition should calculate 3% of qualifying earnings (up to the furlough limit) as part of applying for a grant in respect of the furloughed staff. Some employers in this situation may decide to reduce their contributions to the AE minimum during the furlough period – please see below.

SALARY SACRIFICE ARRANGEMENTS

- The Regulator's updated guidance sets out its detailed expectations for how pension contributions will be calculated where a salary sacrifice arrangement is in place in respect of a furloughed employee.
- Employees' compensation from the CJRS will be 80% of the regular pay actually received (post-sacrifice), up to a maximum of £2,500 per month. For some employees, working out "regular pay" for this purpose will be a fairly complicated calculation.
- The Regulator explains that, where employee pension contributions are paid by salary sacrifice and CJRS

compensation is based on post-sacrifice pay, no further employee contributions should be sacrificed from the CJRS compensation. Instead, employers are expected to continue to pay the total contribution due (employer and employee contributions).

- The Regulator reminds employers to consider any obligations they have under the employment contract or scheme rules to pay contributions of a particular amount or at a particular rate. Subject to such obligations, the Regulator expects employer contributions to be calculated as set out below.

Reminder: how does salary sacrifice work?

- Salary sacrifice arrangements are popular because they carry a National Insurance contribution (NIC) advantage for employers and/or employees.
- Under a salary sacrifice arrangement, the employer and employee agree to amend the employee's employment contract, so that the employee receives a lower salary and instead is provided with an alternative benefit, such as a pension contribution.
- Where salary sacrifice is used, the employer pays the total pension contribution in respect of an employee (representing both the employer's own contribution and the employee's sacrificed contribution).
- Scheme rules commonly calculate contributions (or benefits in a DB scheme) by reference to the member's pre-sacrifice salary.
- An employer's payroll may show an "employee pension contribution" representing the amount the employee has agreed to sacrifice. It should be remembered that under a salary sacrifice arrangement this amount is to be paid by the employer, not the employee.
- Salary sacrifice is not appropriate for all employees, especially those on low earnings. Scheme rules usually provide for regular member contributions to be made when an employee is not in a salary sacrifice arrangement.

Calculating employer contributions for a salary sacrifice arrangement while on furlough

- Regulator guidance explains that employers should calculate the employee's "**notional pre-sacrifice pay**" while furloughed, based on the pay actually received. If the employee's pay is reduced to the level of the CJRS compensation, this figure should be used.
- If the salary sacrifice arrangement includes other benefits as well as pension contributions, these other benefits may need to be included when calculating notional pre-sacrifice pensionable salary.

What is notional pre-sacrifice salary on furlough?

The examples below demonstrate how the Regulator expects notional pre-sacrifice salary to be calculated.

For ease, we have rounded all sums to the nearest whole pound.

Example A: pension contributions calculated on total salary

The employee usually sacrifices 5% of pre-sacrifice salary in return for a total employer pension contribution of 10% and post-sacrifice salary of £1,500 per month. While on furlough, the employee receives £1,200 monthly salary (80% of £1,500). The employee's notional pre-sacrifice salary while furloughed is calculated as follows.

$$\begin{aligned} \text{Notional pre-sacrifice salary} &= \text{Pay whilst furloughed} \div (100\% \text{ less } \% \text{ sacrificed under the salary sacrifice arrangement}) \\ \text{Notional pre-sacrifice salary} &= £1,200 \div (100\% - 5\%) \\ &= £1,200 \div 95\% \\ &= £1,263 \end{aligned}$$

The employer's monthly contribution during furlough

$$\begin{aligned} &= 10\% \times £1,263 \\ &= £126. \end{aligned}$$

Example B: pension contributions calculated on AE qualifying earnings

In this example, the employee sacrifices 5% of pre-sacrifice AE qualifying earnings (rather than 5% of total pre-sacrifice salary) in return for a total employer pension contribution of 10% of pre-sacrifice qualifying earnings and post-sacrifice salary of £1,500 per month. The employee's furlough pay is £1,200 (80% of £1,500).

$$\begin{aligned} \text{Notional pre-sacrifice salary} &= \frac{\text{Pay whilst furloughed} - (\% \text{ sacrificed} \times \text{lower qualifying earnings threshold})}{(100\% - \% \text{ sacrificed})} \\ \text{Notional pre-sacrifice salary} &= \frac{£1,200 - (5\% \times £520)}{(100\% - 5\%)} \\ &= \frac{£1,200 - £26}{95\%} \\ &= \frac{£1,174}{95\%} \\ &= £1,236 \end{aligned}$$

The employer's monthly contribution during furlough

$$\begin{aligned} &= 10\% \times (£1,236 - £520) \\ &= 10\% \times £716 \\ &= £72. \end{aligned}$$

How much pension contribution will the employer be reimbursed from the CJRS?

The employer may reclaim the AE statutory minimum contributions (3% of the employee's qualifying earnings) from the CJRS. In example A, for April 2020 and any subsequent months in 2020/21 this would be calculated as follows.

Example A

Pension contribution recoverable

$$\begin{aligned} &= 3\% \times (£1,200 - £520 \text{ (the lower qualifying earnings threshold)}) \\ &= 3\% \times £680 \\ &= £20.4 \end{aligned}$$

It can be seen that the employer will need to fund £105.60 of the monthly pension contribution itself – unless it reduces pension contributions during the furlough period

and/or agrees with the employee to suspend or alter the salary sacrifice arrangement.

CJRS compensation below the AE qualifying threshold

If an employee's CJRS compensation is below the AE lower qualifying threshold (£520 per month), no employer pension contributions may be claimed. This is the case even if under the employer's pension arrangement it normally pays contributions on the whole of the employee's salary.

The Regulator recognises that, in such circumstances, the employer may wish to reduce its employer contributions to the level of the AE statutory minimum (please see below).

Amending salary sacrifice arrangements

- HMRC has advised that Covid-19 is treated as a "life event", meaning that the terms of a salary sacrifice

arrangement may be altered without losing the NIC advantage in respect of previously sacrificed pay.

- Under previous HMRC guidance, it seems that an employee may opt in or out of sacrificing pension contributions at any time, regardless of whether or not a life event has occurred. However, it is helpful to have confirmation that salary sacrifice arrangements involving other benefits in addition to pension may be altered by reason of Covid-19.
- Employers and employees should note, however, that amending or terminating a salary sacrifice agreement already in place will not affect the amount of benefit payable by the CJRS – as this is generally calculated by reference to the employee's pay in the last pay period prior to 19 March 2020.
- Under most scheme rules, if employee contributions are no longer paid by salary sacrifice, then those contributions become payable by the employee out of salary. However, as explained above, the Regulator expects that no further pension contributions should be sacrificed from the employee's CJRS compensation, where that compensation is calculated by reference to post-sacrifice pay.

REDUCING CONTRIBUTIONS TO THE AUTO-ENROLMENT MINIMUM

- Some employers may wish to reduce their pension contributions to the statutory AE minimum, whether for all staff or only those on furloughed leave. The Regulator points out that an employer's ability to do this will depend on the usual considerations: employment contracts; agreements with providers; scheme rules and need for trustee consent; and any agreements with trade unions.
- In most cases, reducing pension contributions may only be done after 60 days' consultation with the affected members – but see below.

Consulting members before reducing pension contributions

- The Regulator has made clear that the consultation requirements still apply but that it will not take action for a failure to consult for the full 60 days if all of the following conditions are met:
 - The employer has furloughed staff for whom it is claiming under the CJRS.
 - The employer proposes to reduce employer contributions to its DC scheme in respect of the furloughed staff only (not in respect of any staff still working).
 - The reduced contribution rate will revert to the normal rate at the end of the furlough period.
 - The employer has written to the affected employees and their representatives and has described the intended changes and the effects on the scheme and the furloughed staff.
- The Regulator still expects employers to carry out as much consultation as is possible. The regulatory easement on consultation will continue till 30 June 2020 but will be reviewed as matters progress.

AUTO-ENROLMENT DUTIES DURING A FURLOUGH PERIOD

- The operation of the CJRS and any salary sacrifice arrangement is separate from statutory auto-enrolment provisions and any obligations set out in the pension scheme rules or the employment contract.
- An employer's auto-enrolment duties continue to apply as normal, including the duty to re-enrol eligible jobholders every three years, whether staff are still working or are on furloughed leave.
- Payroll processes should be run as normal in respect of furloughed employees, with NICs, tax and pension contributions deducted in the usual way but based on the employee's actual furlough pay.
- Employers whose first re-enrolment date falls in the pandemic period and who are struggling to complete re-enrolment on the third anniversary of their staging date due to Coronavirus may choose a later date up to three months after the third anniversary. The Regulator has set up a re-enrolment date tool to see available dates.

IMPACT OF REDUCED PAY ON DB BENEFITS

- If employees are furloughed, or are required, agree or request to work shorter hours during the crisis, this may impact the calculation of:
 - final pensionable salary for the purposes of final salary benefits; or
 - pensionable salary used for calculating career-average benefits.
- The effect of the reduced salary will depend on the wording of the scheme rules.

FURLOUGHED TRUSTEES

It can happen that one of an employer's furloughed employees is also a trustee of the employer's pension scheme (or a director of the corporate pension trustee). The CJRS does not permit a furloughed employee to do any work that provides services for the employer' organisation or any organisation linked or associated with that organisation.

The CJRS specifically permits company directors who are furloughed to fulfil their statutory duties relating to filing accounts or providing information relating to the administration of the company. In addition, a furloughed employee may undertake training or volunteer work without breaching the terms of the CJRS.

The government guidance does not address the question of whether a furloughed employee who is a pension trustee may continue to act as a trustee during the furlough period. Our view is that in most cases it is acceptable for a furloughed trustee to continue to carry out their trustee duties during the furlough period.

LIFE ASSURANCE BENEFITS FOR FURLOUGHED EMPLOYEES

The terms of any workplace life assurance provision (whether through a registered pension scheme or a group life scheme)

should be checked, to ensure continued coverage during the furlough period. Where death benefits are funded by insurance, the employer may find itself liable for any shortfall between the amount promised under scheme rules (or the employment contract) and the sum actually payable under the terms of the insurance policy.

CONTACT US

We would be pleased to speak to employers, trustees or other professionals who would like to discuss any of the issues covered in this note.

For further information, please speak to your usual Hogan Lovells contact or one of the pension partners listed below.

This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

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