SLAUGHTER AND MAY

C-19

CJRS AND COMPENSATION FOR EMPLOYER PENSION CONTRIBUTIONS

21 April 2020

Further information was issued last week by the government and the Pensions Regulator in relation to the Coronavirus Job Retention Scheme ("CJRS") and compensation for employer pension contributions. The headline item is the extension of the CJRS until the end of June 2020, but there are a number of further areas of detail. In this update we cover:

- the calculation of employer pension compensation;
- salary sacrifice arrangements; and
- amending DC arrangements.

Calculation of employer pension compensation

Background

The HM Treasury direction to HM Revenue & Customs ("**HMRC**") of 15 April 2020[1] and new guidance subsequently issued by HMRC on 17 April 2020[2] confirm the maximum compensation under the CJRS for pension contributions.

Guidance

Broadly, an employer can recoup the lower of two amounts:

- the actual amount it pays to a registered scheme for an employee on furloughed leave; and
- 3% of the employee's gross earnings claimable by the employer under the CJRS ("**furloughed pay**"), above a lower limit. The limit is the same amount of qualifying earnings used for automatic enrolment ("**AE**"), which for the tax year 2020/2021 is £520 per month.

Analysis

- Many employers, who pay minimum pension contributions to employees (through AE or contractual enrolment into a qualifying pension scheme), do not use banded qualifying earnings. Instead, they certify contributions at a rate of 3% or 4% of basic pay or total earnings under what is known as set 1, 2 or 3.

[1] The Coronavirus Act 2020 Functions of Her Majesty's Revenue and Customs (Coronavirus Job Retention Scheme) Direction, dated 15 April 2020.

[2] "Work out 80% of your employees' wages to claim through the Coronavirus Job Retention Scheme", dated 17 April 2020.

- For such employers, who furlough employees, and pay the employees furloughed pay without a top-up, the pension compensation would not cover their full pension costs. The employer is required to contribute at 3% of pay from the first pound of an employee's pay, but compensation only applies for pay above £520 per month (for the tax year 2020/2021). This also means many employers will have to carry out two calculations, covering their usual payroll process and assessing minimum compensation under the CJRS.

  Employers may therefore wish to look to change their pension contributions to reflect the minimum compensation. (See further below on *Changing DC arrangements*.)

- If, in fact, employers pay employees lower contributions than the minimum AE contributions, the CJRS pension compensation will be based on what the employer actually pays. For example, if an employee opts out of a qualifying scheme and is permitted to pay a lower amount of 2% of pay, and receive a matching contribution from the employer, the employer cannot then recover more under the CJRS than it actually has to pay.

  However, nothing in the Treasury direction, or HMRC guidance, would seem to preclude an employer agreeing to continue to make minimum AE contributions, and receive full pension compensation from the CJRS, whilst the employee makes no contributions.

- While compensation is payable for all registered pension schemes, the test in the Treasury direction does not work appear to work well for active members of all defined benefit schemes. In some cases, future service contributions for active members may not be assessed by reference to each employee (as seems to be required by the Treasury direction).[3]

Salary sacrifice arrangements

Background

The Pensions Regulator ("**TPR**") issued further *technical guidance* on 17 April 2020[4] which covers salary sacrifice arrangements.

Salary sacrifice arrangements are commonly used in pension arrangements. They permit an employer to pay reduced National Insurance contributions ("**NICs**") on the basis that:

- the member's pension contributions is paid by an employer instead of the member; and
- the member agrees contractually with his employer to a reduction in salary of the amount of the member contribution.

As the employer is paying less salary, there is less NICs to pay. Other employee benefits for members (such as life cover, set at a multiple of salary) are typically assessed on notional pay, as if the member had not entered into the salary sacrifice arrangement (or pre sacrificed salary).

[3] TPR guidance suggests that CJRS compensation will be payable for members of defined benefit and hybrid pension schemes. See "Automatic enrolment and DC pension contributions: COVID-19 guidance for employers", updated on 17 April 2020, in the section on "*Employers paying more than the statutory minimum*".

[4] "COVID-19 technical guidance for large employers", updated on 17 April 2020.

Guidance

It is clear that where an employee participated in a salary sacrifice arrangement as at 19 March 2020[5], CJRS compensation is based on post sacrificed salary as at 19 March 2020. This means compensation is lower for an employee participating in salary sacrifice than if he had chosen not to do so.

In addition, for employees receiving furloughed pay without a top-up, higher pension contributions will be payable for those employees in a salary sacrifice arrangement (as explained in the analysis section below).

Analysis

- The issue arises because of the way contracts of employment or pension scheme rules deal with salary sacrifice. The employer pension contribution, which includes the equivalent member contribution met by the employer, is typically based on a percentage of pre sacrificed salary.
- Where employees receive furloughed pay, the employer contributions would not be based on a percentage of furloughed pay, but rather a notional amount (based on pre sacrificed salary). A higher pension cost arises for the employer because CJRS compensation for pension contributions is based on furloughed pay and not this notional amount[6].
- In other cases, the employer will have agreed to pay a fixed amount of pension contribution on behalf of the member, which does not change to reflect the lower furloughed pay received by the member.
- The guidance notes that HMRC has advised that COVID-19 counts as a "life event". This provides further reassurance that the terms of a salary sacrifice arrangement could be changed, if the employment contract is updated with the agreement of the employee to unwind the salary sacrifice arrangement. (Note that if the salary sacrifice arrangement is unwound, this cannot be done retrospectively to increase the amount of CJRS compensation.)
- However, as well as changing the employment contract, the pension scheme rules will also continue to apply to the employer. The rules may need amending. (See further below on *Changing DC arrangements*.)

Changing DC arrangements

Background

As explained above:

- employers who pay minimum pension contributions assessed on basic pay or total earnings, may want to change DC contributions to reflect the pension compensation provided under the CJRS ("**employer AE change**"); and/or

[5] For workers who are not "fixed rate employees", compensation is determined by looking at average monthly (or daily) pay in the tax year 2019/2020 or the corresponding amount paid in the previous calendar year.

[6] As noted earlier (Calculation of employer pension compensation), the CJRS compensation for employer pension contributions also includes a lower limit based on qualifying earnings.

- employers with employees in salary sacrifice arrangements, may want to unwind these arrangements to ensure that they are not having to pay higher amounts of pension contributions ("**salary sacrifice change**").

Guidance

TPR highlights that in addition to contractual arrangements with employees, employers also need to consider their pension scheme's governing rules.

Employer AE change: The guidance notes that employers may be able to change their scheme rules to match the AE statutory minimum employer contribution based on qualifying earnings. They could end the current certification period early under the certification rules. Where employers have a mixture of furloughed and non-furloughed staff, this may mean that they need to recertify in respect of the non-furloughed staff, after carrying out the usual review at the end of the certification period.

However, as this would be likely to mean a reduction in the employer contribution, employers would need to consider the same list of factors outlined in the section of the main guidance (first issued on 9 April)[7] on reducing employer contributions to the AE statutory minimum employer contribution.

Salary sacrifice change: TPR highlights that if an employer wishes to change the pension contribution payment obligation in the pension scheme rules to reduce their contribution, they will need to consider the main guidance. In addition, employers with at least 50 employees are required to consult if they wish to introduce member contributions for the first time, or increase existing contributions.

Analysis

- Employers should take legal advice on changing pension scheme rules. However, some points to note are:
  - *Regulatory easements in place until 30 June 2020:* On the requirement for employers, with at least 50 employees, to consult on certain pension changes, TPR will not take regulatory action in respect of a failure to consult for the full 60 days, where the employer is only proposing to reduce contributions for furloughed staff to align with the CJRS. (However, the regulatory easement does not stop other potential consequences of the breach, such as employee claims in relation to a change to pension terms);
  - *Contractual terms can override scheme rules:* Where a valid change can be made to employees' contractual terms, this can override pension scheme rules themselves; and
  - *The rules for a Group Personal Pension ("GPP"):* Where the pension scheme used is a GPP, it may be possible to change the arrangements for paying contributions without the need for a new or amended contract with the GPP provider.
- Employers also need to consider:
  - other related benefits including death and incapacity benefits, and any related insurance; and

[7] "Automatic enrolment and DC pension contributions: COVID-19 guidance for employers", updated on 17 April 2020.

   - any agreements they have with recognised trade unions or other staff representative forums to discuss or notify changes.

- TPR has updated separate guidance on 17 April 2020[8], which is directed at trustees of pension schemes. The updated guidance is not particularly helpful for employers that need under their pension scheme rules to obtain trustees' agreement to change DC contributions. The guidance provides:

  "[trustees] will need to make sure that the decision you take is in the best interests of the members. This can include factoring in the likelihood of the employer being able to continue as a going concern if they continue to pay the current rate of contributions, but you should make sure you are satisfied that this is a genuine risk and give thought to whether any change should be temporary.

  If the power rests solely with the employer, we have recommended that they notify you before making any changes."

  There may be cases where the employer cannot demonstrate that there is a genuine risk that the employer can no longer continue as a going concern, albeit that the employer has good reasons for reducing pension contributions to match the CJRS compensation provided.

For more information on this complex area, please get in touch with your usual pensions contact at Slaughter and May.

[8] "DC trustees: COVID-19 scheme management and investment guidance", updated on 17 April 2020.

If you would like further information about the impact of COVID-19 on your business, please speak to your usual Slaughter and May contact.

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