What happens to my pension if I am furloughed?

Millions of employees have been furloughed in the UK this year since the introduction of the government's Coronavirus Job Retention Scheme, which has been extended until the end of October.

Under the scheme, the government will pay up to 80% of salary, up to a maximum of £2,500 per month.

The scheme also covers employee's pension contributions.

However, that does not mean that furloughed employees are not suffering a hit to their pensions, if their employer doesn't top up their income to their full salary. If you are on a reduced salary, your pension contributions are likely to fall.

Here, we look at how your pension may be impacted under the furlough scheme, and the importance of maintaining pension contributions if you can afford to do so, to provide for a comfortable retirement.

How does the Coronavirus Job Retention Scheme work for pensions?

Alongside salary payments, the government is covering employers pension contributions at the minimum 3% auto-enrolment contribution, and National Insurance.

However, the government will start phasing in a shared cost arrangement with employers. From 1 August, employers will have to pay employees' pension contributions and National Insurance.

From 1 September, the government will only cover 70% of salaries, or up to around £2,190, and from 1 October only 60% of salaries, or up to £1,875.[1] Employers will be responsible for making up the difference, enabling furloughed staff to continue receiving 80% of salary and pension contributions.

What does this mean for pension contributions?

Your pension contributions and your employer's contributions under the furlough scheme will continue, unless you are told otherwise or choose to opt out of contributing. However, they will be based on your furloughed salary.

Under auto-enrolment, you must contribute at least 8% of your salary each month into your pension. A total of 5% is paid by the employee (with 1% of this being tax relief), and at least 3% is paid by your employer. Both you and your employer may pay in a greater amount.

The government is replacing the 3% employer contribution into your workplace pension under the furlough scheme, on qualifying earnings between £520 and £2,500 per month.

But if your employer typically contributes more than the minimum into your pension, the government will not match the greater amount. Your employer may choose to cut their contributions to the minimum 3%, and at present this is allowed without the typical consultation period that regulators impose for reducing employer pension contributions.

If you are furloughed, none of your personal contributions into your workplace scheme are covered. You must still contribute on top of the government contribution into your pension.

So if your salary in normal times is greater than £2,500 a month, you are likely to be receiving a smaller contribution into your pension. That's unless you or your employer are making up the difference in contributions.

How does this work, exactly?

Pension contributions are taken from your 'qualifying earnings'. This is your earnings, before income tax and National Insurance are deducted. Qualifying earnings fall between a certain limit, which for the tax year 2020-21 is set from £6,240 per year, or £520 per month, to £50,000.

For example, if you receive a furloughed salary of £2,500 per month, your pension contribution is £99, or 5% on qualifying earnings of £23,760 per year. Meanwhile, your employer's contribution amounts to £59.40 per month, or 3%. Your total monthly pension contribution would therefore be £158.40. This includes the 1% tax relief on contributions, at 20% for basic-rate taxpayers (or 40% for higher-rate taxpayers).

However, the rules are slightly different for Scottish taxpayers.[2] Tax relief is given at 20% and the additional 1% for intermediate rate taxpayers, or additional 21% for higher-rate taxpayers, can be claimed via their tax return.

How will the changes to the furlough scheme impact on my retirement savings?

The changes to the scheme from 1 August to share the cost with employers won't change how much is paid into your pension. You will still need to pay 5% into your pension, while your employer will have to pick up payment of the 3% minimum from 1 August, up to the furloughed income you receive.

However, the impact of shifting the responsibility to employers to top up the furlough scheme and pay pension contributions could place further pressure on businesses.

What if I'm signed up to salary sacrifice?

Under a pension salary sacrifice scheme, you accept a lower salary in exchange for your employer paying a greater amount into your pension, and less in National Insurance. However, salary sacrifice benefits such as increase pension contributions are not part of the furlough scheme.

If you are furloughed, the 80% pay is based on your smaller salary, unless this is topped up by your employer. So you will only receive 3% of qualifying earnings into your pension. Your employer isn't able to use the government grant to pay for additional benefits under a salary sacrifice scheme.

If you are losing benefits under a salary sacrifice scheme as a result of being furloughed, you may want to ask your employer how contributions may be made up in the future. However, cashflow is likely to be an issue for companies that have furloughed their staff, and this could be problematic.

Experts say that an employer is likely to suspend these additional payments, while you are furloughed. But under contractual agreements made with employees under a salary sacrifice scheme, they may be forced to pay these, even after you return to work.[3]

1. Gov.uk
2. Gov.uk
3. TPR clarifies treatment of salary sacrifice under furlough, FT Adviser

It may be worth seeking professional advice on your options, if losing pension benefits while being furloughed is a concern for you.

I'm on a reduced income. Can I stop paying into my pension to boost my earnings?

If you are furloughed and have suffered an income fall, or want to cut your outgoings, it is possible to opt out of paying into your company pension. But remember that saving towards retirement is very important, and it's wise to consider cutting out other costs before turning to your pension contributions. It is a statutory offence for employers to encourage employees to opt out of auto-enrolment.

Bear in mind that you benefit from tax relief alongside employer contributions when paying into a pension. Employer contributions are effectively a free pay rise and can make a substantial difference to your retirement pot. Meanwhile, the impact of compounding – or earning returns on your returns – can make an enormous difference to the size of your pension, over time.

What if I'm in a defined-benefit scheme?

Gold-plated defined-benefit schemes pay out a guaranteed income at retirement, but they are increasingly rare. They are the most generous type of pensions available, and few companies can afford to sustain them. The majority are closed in the private sector, where employees are most likely to be furloughed.

The government announcement on the furlough scheme does not make specific reference to defined-benefit schemes. So it remains unclear what impact being furloughed will have on these types of pensions. However, if no change is made to pay and benefit terms under the scheme, the impact is expected to be minimal.

Remember that if you have been furloughed, wherever you are on your retirement journey, and whatever type of pension you have, an adviser can help your plans get back on track. They can work with you to define your goals and help you establish what you need for a comfortable retirement.

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