Stakeholder pensions — The compliance regime

Received: 4th November, 2002

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Abstract This paper is designed to give an overview of the compliance regime relating to stakeholder pensions. It covers the following areas: what employers have done to comply; remaining outside the stakeholder compliance regime; issues on corporate acquisitions; employers' exposure to investment performance; financial services issues and payroll deduction issues.

Keywords: *stakeholder; stakeholder conditions; group personal pensions; eligibility, payroll deduction; Financial Services Authority; Occupational Pensions Regulatory Authority; employer access*

Stakeholder: The new regime

Employers have had to comply with the new obligations to designate and provide access to a stakeholder pension scheme since 8th October, 2001.¹ Most employers now have designated stakeholder schemes. However, employers that have not taken appropriate measures to comply face fines by the Occupational Pensions Regulatory Authority (Opra) of up to £50,000 for each breach of these obligations. Fines can also be imposed on a manager, director or other officer of a company where the breach is due to the manager's or director's or other officer's connivance, neglect or default.

Opra originally took a lenient approach and tried to encourage compliance by education rather than fines. It is likely, however, to take a

harder approach in the future. Also, on past experience, if Opra comes across a case of deliberate non-compliance where the employer does not indicate it will be willing to take steps to remedy the situation, it will impose fines.

This paper will:

- outline the main approaches that employers have taken to comply
- consider what employers need to do to remain compliant where they have widened their eligibility requirements in their occupational schemes to take themselves outside the scope of the stakeholder requirements
- consider what employers need to do to remain compliant where they are relying on the personal pension scheme exemption
- consider what employers need to do

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to remain compliant where they have designated a stakeholder scheme alongside the main occupational pension scheme

- consider some stakeholder related issues that may arise on corporate transactions
- consider some ongoing compliance issues that will arise where employers have designated a stakeholder scheme.

What have employers done to comply?

The options chosen by employers varied depending on what sort of pension arrangements they already had for their employees before 8th October, 2001. Employers with an existing occupational pension scheme for employees had the option of:

- widening the scheme's eligibility requirements so the employer has no relevant employees (could include offering new employees membership of the scheme on less good terms subject to sex and age discrimination issues);
- keeping eligibility requirements as they are but designating a stakeholder scheme and complying with employer access requirements in relation to any 'relevant employees' who are currently not eligible to join an occupational pension scheme; or
- replacing the existing occupational pension scheme with a personal pension scheme meeting certain requirements to which the employer contributes at the rate of at least 3 per cent of basic pay and operating a payroll deduction facility if requested to. Broadly, the personal pension scheme cannot have any termination penalties on discontinuance of contributions or transfers out.

Employers with existing group personal pension schemes had the option of:

- setting up an occupational pension scheme offering membership to all their relevant employees;
- taking advantage of personal pension scheme exemption. Employers would need to operate their employment contracts so that a minimum of 3 per cent employer contribution is made and ensure that contracts have no penalties on termination or transfer out;
- designating a stakeholder in place of a personal pension scheme.

Employers with no existing pension scheme had three main options:

- set up an occupational pension scheme (highly unlikely);
- contribute at least 3 per cent of employees' basic pay to a personal pension scheme meeting certain minimum requirements (not particularly likely as it will cost the employer money); or
- designate a stakeholder scheme and operate the employer access requirements in relation to its employees to whom the above two options do not apply (most common).

Employers currently can still rely on the life cover loophole if they offer all employees not eligible to join an occupational pension scheme life cover under a separate occupational pension scheme or under the trusts of the main scheme. The Department of Works and Pensions is aware of this loophole and is monitoring the situation for evidence of abuse, but has not yet taken any steps to close it. It is not very sensible to plan a compliance strategy on the basis of the continued existence of this loophole.

In practice, most employers operating

larger occupational pension schemes did not take radical action and start engaging in a major benefit redesign. Instead they attempted to do the minimum necessary to avoid disrupting their existing arrangements. The option chosen by employers with larger occupational pension schemes depended on balancing the administrative burden, costs and compliance risks associated with operating a stakeholder scheme against the administrative burden, costs and compliance risks associated with widening their membership. However, not all employers that have gone down the stakeholder compliance route have realised fully what these compliance obligations involve.

The issue employers objected most to when deciding whether or not to widen their eligibility requirements was allowing non-permanent employees to join. There is no specific exemption from the stakeholder requirements for non-permanent employees. Employees with less than three months' service are not 'relevant employees' for the purposes of the stakeholder requirements. Similarly, employees will not be 'relevant employees' if they can join an occupational pension scheme after a waiting period of up to 12 months. Two-year vesting requirements are also permitted. Accordingly, even if non-permanent employees do have the option of joining an occupational pension scheme it may not be a very attractive option unless they see themselves as having a long-term future with the company. Many employers therefore took a pragmatic approach and proceeded on the basis that even if non-permanent employees could join, most of them would not take advantage of the option. Given the new requirements that have been introduced preventing discrimination against fixed-term workers from 1st October,

2002, this has proved a sensible decision.²

In practice about 60 per cent of the author's clients with large occupational pension schemes chose to widen their eligibility requirements and about 40 per cent went down the stakeholder designation route. Regardless of whether a client designated a stakeholder scheme, some clients have also entered into an arrangement with a stakeholder provider to allow members of the main occupational pension scheme earning £30,000 or below to also contribute to the new stakeholder scheme under the new partial concurrency requirements.

What should employers watch out for if they have widened their eligibility requirements to ensure that they remain outside the scope of the stakeholder requirements?

Employers with more than five employees will only remain exempt if they continue not to have any 'relevant employees'.³ If they take on even one 'relevant employee' they have only three months to select a stakeholder scheme and complete the designation process after becoming subject to the stakeholder requirements.⁴

It is therefore worth considering again what a 'relevant employee' is for this purpose. The Government has unhelpfully defined 'relevant employee' negatively.⁵ Relevant employees are all the employees of an employer employed in Great Britain and also in the case of an employer resident or incorporated in any part of Great Britain, all employees employed outside the UK except:

- any employee whose employment qualifies him for membership of an occupational pension scheme of an employer

- any employees whose earnings fall below the lower earnings limit for National Insurance purposes in any one or more weeks within the last three months
- any employee whose employment would qualify him or her for membership of any occupational pension scheme of the employer had he or she been employed for more than 12 months
- any employee whose employment would qualify him or her for membership of an occupational pension scheme of an employer if he or she was over age 18 or more than five years below the normal pension age for that scheme
- any employee who (i) had he wished to join an occupational pension scheme of the employer at some point in the past, would have qualified for membership of the scheme and (ii) is now excluded from membership of that scheme because he did not join the scheme at an earlier time
- any employee who has been employed by the employer for a continuous period of less than three months
- any employee who is ineligible by virtue of any enactment relating to tax or any restriction imposed by the Inland Revenue, to make contributions to a stakeholder pension scheme
- any employee who is now excluded from active membership of an occupational pension scheme of the employer because that employee has ceased to be a member or active member of that scheme.

If an employer has concluded that it is outside the scope of the stakeholder requirements because its only employees eligible to join a stakeholder scheme

have earnings below the National Insurance threshold in any time during the previous three months, the employer will have to monitor the earnings of those employees. As soon as the employee has earnings above the National Insurance contribution threshold for a continuous period of three months, the employer will generally be caught.

Similarly, if an employer or the trustees exclude an employee from membership of the occupational pension scheme, the employee will become a 'relevant employee' and the employer may then have to designate a stakeholder scheme and comply with the other stakeholder requirements just for that employee.

It will be necessary to ensure that contracts of employment for new employees give a contractual right to payroll deduction and that such employees are provided with information packs on the stakeholder scheme. This may be difficult with multiple employees on multiple sites.

Since 1st October, 2002, it has also been necessary as a separate matter to comply with the new requirements relating to discrimination against fixed-term workers. These new requirements extend to pensions. Unless an employer can show that excluding an employee from membership of an occupational pension scheme is objectively justified, the eligibility requirements may need to be amended to meet these requirements.

What should employers do to ensure that they remain under the personal pension scheme exemption?

Employers do not need to comply with the employer access requirements if it is a term of the contract of employment of every relevant employee (other than an

employee who has not reached the age of 18) that the employer will contribute at the rate of at least 3 per cent of basic pay to a personal pension scheme chosen by the employer meeting certain requirements.⁶ Employers must also, if requested, operate a payroll deduction facility in relation to such contributions.

The personal pension scheme must not generally impose any charge or penalty on any member for transferring all or any of his or her funds out of that scheme or for ceasing to contribute to the scheme.⁷

Employers can still take advantage of this exemption if they impose an obligation to make matching contributions of up to 3 per cent or a higher match where the arrangement was in place before 8th October, 2001.⁸

The Stakeholder Regulations provided originally that the employees' contracts would not need to be formally amended if an employer could provide written evidence to show that contributions are being made and have been continuously made from a date prior to 8th October, 2001, as if each employee had a term in his contract that would satisfy the requirements described above. The contracts of post-8th October members would have had to be amended.

However, the Stakeholder Regulations were altered at a late stage so that an employer can still be within the exemption in relation to any employee taken on before or on or after 8th October, 2001, if it can provide written evidence to show that contributions are being made and continue to be made as if the employee had a term in his contract that the employer will pay 3 per cent contributions and operate a payroll deduction facility.⁹

In practice it is, therefore, not necessary to amend formally the employees' terms of conditions of employment whatever date employees

join the company, although it would be good practice to do so.

What should employers do to ensure that they remain compliant if they have gone down the designation route for employees not eligible to join the main occupational pension scheme?

Those employers that have chosen to designate a stakeholder scheme still need to ensure that they comply with all relevant stakeholder requirements.

They should already have consulted with their relevant employees and any organisations representing them before the designation took place.¹⁰ Employers should also check the Opra website to ensure that all their 'relevant employees' are able to contribute to the designated stakeholder scheme. Employers should also have provided employees with the name and address of the stakeholder scheme.¹¹

Employers are also required to allow representatives of the designated scheme or schemes reasonable access to its relevant employees for the purpose of supplying them with information about the designated scheme or schemes.¹² In practice, unless there are large numbers of employees eligible to join concentrated on one site it is unlikely that many providers will want to arrange group presentations. Access is likely to involve making available information packs about the scheme and/or providing web-based or telephone-based assistance.

Employers are under an ongoing obligation to ensure that at all times there is at least one designated stakeholder scheme that offers membership to all its relevant employees.¹³ Given that it is expected that there will be a significant consolidation in the number of

stakeholder providers, this may necessitate designating a new stakeholder scheme for employees if the existing designated scheme ceases to be registered as a stakeholder scheme. An employer then has four months to designate a new one.

Employers, if requested by a relevant employee who is a member of the designated stakeholder scheme, must deduct contributions from the employees' remuneration and pay them to the trustees or managers of the designated stakeholder scheme (see below).¹⁴

Issues on corporate acquisitions

Stakeholder related issues may arise in corporate acquisitions. Consideration needs to be given to how the target has complied with stakeholder.

On a business acquisition, if the Seller has designated a stakeholder scheme in relation to some or all of the employees concerned, the employees will cease to be covered by the designation immediately following the sale. If these employees are not eligible to join the Buyer's occupational pension scheme or are not covered by an existing designation by the Buyer, steps will need to be taken to comply with the stakeholder requirements. The Buyer will either need to designate a stakeholder scheme, start contributing at 3 per cent of basic pay to a qualifying personal pension scheme or set up an occupational pension scheme.

If the shares of a company are acquired that has designated a stakeholder scheme, that designation will remain in force following the acquisition. Accordingly, nothing needs to be done. However, the employer that is being acquired could then be taken out of the scope of the stakeholder requirements if the new employer is admitted to participation in the main group company

scheme and all persons who would otherwise be 'relevant employees' are permitted to join the occupational pension scheme.

Employers' exposure in relation to investment performance of a stakeholder scheme

Employers were very concerned at the time stakeholder pensions were introduced that they would be liable for any poor investment performance of the designated stakeholder scheme. As a result of lobbying by employers, statutory protection was enacted so that an employer is not, whether before designating a scheme or at any time while a scheme is designated, under any duty to investigate or monitor, or make any judgement as to the past, present or future performance of the scheme.¹⁵

Accordingly, the employer is not at risk if the stakeholder scheme is picked at random, or the employer fails to monitor its performance. However, this does not mean that there will not be an employee relations problem if a badly performing scheme is chosen. Many employers therefore took financial advice before designating.

If an employer takes it upon itself to investigate or monitor the performance of a scheme, it would be liable if it acted negligently. However, if an employer takes advice and acts upon it, it is difficult to see how the employer could be liable under general negligence principles.

The statutory protection only applies to the designation of stakeholder schemes, not for the use of a scheme as an 'AVC' scheme for employees under new concurrency requirements. It would therefore be prudent for an employer to take advice and act on it before arranging a scheme of this type for its employees and to review the

performance of the scheme at regular intervals.

Financial services issues

Unlike interests under occupational pension schemes, interests under stakeholder schemes will not be exempt from the financial services regime.

Employers have been very reluctant in the past to tell their employees about their group personal pension schemes or encourage employees to join because of concerns that if they did so they would be carrying out a breach of the financial services requirements. Guidance has been issued which confirms that merely distributing application forms or arranging for the payment of employer or employee contributions, or arranging for representatives of a personal pension scheme provider to talk to employees, will not result in an employer being caught. An employer will generally only be caught if it acts in the course of business. An employer will only be treated as acting in the course of business if it gains some form of pecuniary benefit for arranging for its employees to join (such as the reduction of a premium on a general insurance contract or the receipt of commission), or where the employer is in the same group of companies as the provider. The position should remain the same in relation to stakeholder schemes.

Employers can also give generic advice on pension scheme investments as long as it does not comment on the individual merits of an investment. Even if an employer were to give specific advice on the merits of its stakeholder scheme, it would only be caught if it gave this advice in the course of business. Again, generally it will not be treated as giving the advice in the course of business unless it gains some form of pecuniary advantage. Nevertheless, it is not a good

idea to go around saying that the individual funds offered by an employer's designated stakeholder scheme are the best thing since sliced bread. The employer might then be sued under general negligence principles if the funds performed very badly, unless the employer could demonstrate that it had some basis for making the statement.

The Department of Works and Pensions guidance on this issue is more simplistic. It just states:

'You can give employees help and extra information about the benefits of saving for retirement. But, you must not advise your employees. Every individual must make up their own mind about the best way to save for their retirement. For example, you must not tell your employees that they should or should not sign up for a stakeholder pension, or that they must join your designated scheme. A stakeholder scheme is just one of the pension options available, but there may be another option that suits the individual better. The choice is up to the individual. The FSA strictly controls who can give financial advice, and what advice can be given.'

If this advice is followed an employer cannot go far wrong.

Another point to watch is that under the Financial Services regime, employers are prohibited from issuing 'investment promotions' unless they are produced or approved by the provider. Accordingly, employers should ensure that any literature distributed about the stakeholder scheme has been prepared by or approved by the stakeholder provider.

Payroll deduction facility – Notice requirements

Employers have to operate a payroll deduction facility but it is up to employees to decide whether to use it.

Various notices have to be issued to

employees when the employee requests the employer to make contributions for the first time, when contributions are varied and at the time the employee requests the termination of contributions.¹⁶

When an employee requests the employer to make deductions of the employee's contributions to the designated stakeholder scheme for the first time, the employer must within two weeks of receiving the request issue a notice containing the following information:

- the manner in which the employer will accept requests to make, vary or cease such deductions;
- advice that, where an employee requests an employer to make or vary deductions of the employee's contributions to a designated stakeholder scheme the employer need not comply with that request within six months (or lesser agreed period) of any previous request to make, vary or cease such deductions;
- advice that the employee may, at any time, require the employer to cease such deductions;
- advice that where the employer is required to comply with a request to make, vary or cease such deductions the request will be complied with as soon as possible but no later than the pay period following the one in which the request is made, unless the request relates to a later pay period than the one following that in which the request is made, where it must be complied with by the end of the following pay period;
- advice that:
 - the trustees or managers of the scheme may refuse to accept a contribution if accepting it would contravene the scheme's tax-exemption or tax approval;

— if the documents establishing the scheme allow it the trustees or managers of the scheme may also refuse to accept payments of less than £20;

- broadly that the employer need not comply with a request to deduct contributions if the trustees or managers of the stakeholder scheme have informed the employer that they will refuse to accept any contributions on the above or certain other specified grounds.¹⁷

Where an employee requests the employer to cease to make deductions from the employee's remuneration, the employer must generally comply with the request as soon as possible, but no later than the end of the pay period following the one in which the request is made.¹⁸

A notice must also be given in writing to the employer:

- that the employer is not required to comply with any further request to make such deductions, if that further request is made within six months of the employee requesting the deductions to cease; and
- that the employee may make payments at a rate of his choosing (subject to the trustees or managers refusing to accept them where this is permitted under the Stakeholder Regulations) directly to the designated stakeholder scheme.

This notice must be issued generally prior to the end of the pay period following that in which the request to cease contributions is made.

Employers must comply with a request to vary deductions of an employee's contributions to a designated scheme as soon as possible, and no later than the pay period following that in which the

request is made, or if the request relates to a later pay period then the one in which the request is made, then that later pay period.¹⁹ This does not give employers a great deal of time to action the requests. Systems therefore need to be put in place to ensure that requests to operate a payroll deduction facility are dealt with promptly.

Once the employer has started to deduct contributions, employers are only required to comply with a request to vary the rate of contributions every six months, but where it does so it has to issue a notice to the employee containing certain detailed information specified in the Stakeholder Regulations.²⁰

Employers also do not have to comply with requests to deduct contributions where such a deduction is below any lower limit imposed by the stakeholder scheme (stakeholder schemes are required to accept any contribution of £20 and above), or the deduction would contravene the scheme's tax approval. However, where the employer refuses to deduct a contribution because it is below the scheme's minimum contribution limit, another notice has to be issued containing very detailed information about the reason why the contribution has been refused.

It will be appreciated that the stakeholder notice requirements are quite onerous and employers will need to put in place efficient systems to ensure that they are complied with.

Payroll deduction — other requirements

Stakeholder pension schemes will generally be subject to the same requirements as apply to personal pension schemes where contributions are made directly to its scheme:

- **Employer contribution record:** the employer must secure that there is

prepared, maintained and, from time to time, revised, a record showing the rates and due dates of the contributions payable under the direct payment arrangements.¹² The employer will therefore need to update the record every time an employee leaves or joins scheme;

- **Due dates:** the due date for employee contributions is 19 days after the end of the date such contributions are deducted from salary.²² Due dates for employer contributions will be the date specified in the employer contribution record;

- **Employer contribution record to be made available to trustees or managers:** the employer has to supply a copy of the record to the trustees or managers of the stakeholder scheme by the date that is likely to result in the copy of that record being available to the trustees or managers of that scheme and no later than the date upon which the first contribution under that record is payable;²³

- **Time limits for giving notice of non-payment to Opra:** the trustees or managers of a stakeholder scheme are required to report late payment.²⁴ Accordingly, if an employer does not have efficient payroll systems it will be reported and may face fines from Opra.

Implications of stakeholder pensions for employers

To sum up, even if an employer has attempted to avoid stakeholder pensions by widening the eligibility requirements of its occupational pension scheme, it will still need to be vigilant to ensure that it is not inadvertently caught by the stakeholder requirements at a later date.

If an employer has designated a stakeholder scheme for its employees who cannot join the main occupational pension scheme, the ongoing compliance requirements are more onerous than is commonly realised. Employers will need to have efficient payroll systems interfacing properly with those of the stakeholder provider.

Employers will need to update regularly their contribution schedules and ensure that contributions are paid over within the permitted time limits. Employers will also need to ensure that the appropriate notices are issued when contributions commence being deducted, are varied or cease.

To avoid putting a company's finance director at risk, it is advisable to treat the new stakeholder obligations very seriously.

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