



Failures to pay pension contributions by employers

EMPLOYMENT, PENSIONS AND BENEFITS BRIEFING 189 (SUPERSEDING BRIEFING 104)

This briefing looks at the consequences of employers not paying contributions to pension schemes or paying them late. In particular it looks at the notification obligations that may arise and the sanctions that could be imposed on employers.

Schedule of contributions

Under the scheme specific funding regime contained in part 3 of the Pensions Act 2004, most defined benefit occupational pension schemes must maintain a schedule of contributions.

If an amount specified in the schedule of contributions (and recovery plan) is not paid on the due date, it is enforceable by the trustees as a debt. The trustees will have the usual remedies of an unsecured creditor (eg bring proceedings or seek to wind-up the employer).

The trustees will want to be able to demonstrate that they have taken reasonable steps to protect the scheme. Usually this will be to seek to enforce the debt unless there is a good reason not to (eg if they can be persuaded that recovery is likely to be greater out of a restructuring than it would be out of a normal enforcement). Trustees are obliged to keep records of any action taken by them to recover any unpaid contributions (or any section 75 debt) under regulation 11(2) of the Scheme Funding Regulations 2005.

Scheme winding-up

The trustees may also have powers under the scheme trust deed and rules. For example, they may have a power to wind-up the scheme (and so trigger a section 75 buy-out debt on the employer) if the employer defaults in any of its obligations. The precise wording of the relevant rules will need to be considered.

It is quite common to find a provision allowing the trustees to wind-up a scheme if the employer serves a notice saying that it will cease to contribute. Mere failure

to pay seems unlikely to trigger this right. However, if there is a more general 'deficit recovery' type provision, this could be triggered if the employer fails to take action to secure the solvency of the scheme following a demand by the trustees to do so.

The scheme rules would need to be checked to see if they contain any partial winding-up provisions. These can be complex to operate.

Notifications

There are special notification rules applicable to a failure to pay under the statutory schedule of contributions.

If the trustees 'have reasonable cause to believe that the failure is likely to be of material significance in the exercise by the Pensions Regulator (the Regulator) of any of its functions', they are obliged to give notice of the failure to the Regulator and to all the members of the pension scheme within a reasonable period under section 228(2) of the Pensions Act 2004.

These notification obligations only arise if the failure to pay is likely to be of 'material significance' to the Regulator.

The Regulatory Code of Practice 03 (funding defined benefits) includes some guidance on what is likely to be material (paragraphs 163 and 164). Leaving aside fraud, dishonesty or mistaken failure to pay, the guidance indicates that failure to pay is likely to be material if:

- there is an immediate risk to members' benefits;
 - contributions remain unpaid for more than 90 days;
- or

- the trustees ‘conclude, after discussions with the employer, that there is no early prospect of contribution under payments being corrected, for example because of the financial circumstances of the employer or for any other reason.’

If the trustees decide that the failure is material and a report is necessary, the report must be made within a ‘reasonable period’. The Regulatory Code of Practice suggests that:

- 10 working days is reasonable for a report to the Regulator; and
- one month is reasonable in the case of reports to members.

Note that the obligation is for the trustees to make a report to all members. This will include active members (current employees), deferred members and pensioners.

If there is in fact a failure to pay contributions the employer may feel it also wants to notify members (at least its current active employees) explaining the position.

The reporting obligation is on the trustees not on the employer. However, it may be argued that a failure by an employer to pay contributions due under the schedule of contributions, is also a breach of a duty arising under an enactment and so requires a report by the employer to the Regulator under section 70 of the Pensions Act 2004.

Penalties

The trustees can be subject to a civil penalty of up to £50,000 under section 10 of the Pensions Act 1995 if they fail to report to the Regulator and members in accordance with section 228 of the Pensions Act 2004. If the trustee is a company then liability may also extend to directors of the trustee company (up to £5,000 maximum).

A civil penalty can also be levied by the Regulator on the employer if it fails ‘without reasonable excuse’ to make a payment due under the schedule of contributions. One circumstance that might justify non-payment is in a restructuring where there is a general standstill.

Notifiable events

Separately from the notification requirements set out above, there is an obligation on an employer to notify the Regulator ‘as soon as reasonably practicable’ following a

notifiable event in relation to the employer (section 69 of the Pensions Act 2004). The notifiable events include a decision that is intended to result in a debt (including a contingent debt) that is or may become due to the scheme not being paid in full. In some circumstances this could apply to a failure to pay contributions.

Failure to notify the Regulator could render the employer liable for a civil penalty (unless it has a reasonable excuse).

Defined contribution schemes

An occupational pension scheme providing only money purchase benefits (or money purchase benefits plus defined benefits only on death) will not be subject to the scheme specific funding regime and so will not maintain a schedule of contributions (section 221(1)(a) of the Pensions Act 2004; and regulation 17 of the Scheme Funding Regulations 2005).

However, most money purchase schemes must still prepare, maintain (and if necessary revise) a ‘payment schedule’. Although a payment schedule must contain similar information to a schedule of contributions, unlike a schedule of contributions it does not need to be certified by the scheme actuary (section 87 of the Pensions Act 1995).

Personal pensions/stakeholder pensions: direct payment arrangements

Where there is a direct payment arrangement by employers to a personal pension or stakeholder pension scheme the provider must monitor the payment of contributions by or on behalf of the employer under the direct payment arrangements (section 111A of the Pension Schemes Act 1993).

Similar notification requirements to those that apply to a failure to pay under a schedule of contributions apply to a failure to pay under a payment schedule or under direct payment arrangements. Again, under the Regulatory Code of Practice 05 (reporting late payment of contributions to occupational money purchase schemes) and Regulatory Code of Practice 06 (reporting late payment of contributions to personal pensions), late payments are likely to be considered as material where contributions remain unpaid 90 days after their due date (see paragraphs 14 and 21 respectively).

Member contributions

An employer must pay to an occupational or personal pension scheme any contributions deducted from members' pay within 19 days of the end of the month in which the contributions are deducted (this is commonly referred to as the '19 day rule'). Contracted-out minimum payments (to arrangements contracted-out on a money purchase basis) need to be paid by the employer to the trustees within 14 days of the end of the tax month in which the liability arose (section 49 of the Pensions Act 1995; and regulation 32 of the Contracting-out Regulations 1996).

It is an offence under section 49 of the Pensions Act 1995 and section 111A of the Pension Schemes Act 1993 for a person knowingly to be concerned in the fraudulent evasion of this duty by an employer.

An employer that fails to pay member contributions within the prescribed time may be subject to a civil penalty under section 10 of the Pensions Act 1995.

Other contributions

The position on any other amounts payable (ie not covered by the schedule of contributions) depends on whether or not there is a legal obligation on the employer to pay (eg under the terms of the governing trust deed).

If there is a legal obligation, failure to pay on the due date is treated, effectively, as a loan by the trustees to the employer. Loans to an employer (or an associated employer) are usually illegal under section 40 of the Pensions Act 1995 (restriction on employer-related investments). The section 40 prohibition does not apply if the amounts owing are due under the schedule of contributions or payment schedule (regulation 13(6) of the Investment Regulations 2005).

Money purchase benefits

If contributions are being credited towards money purchase benefits, the member may lose out if they are paid or invested late.

The Pensions Ombudsman has held in at least three cases that late payment may be maladministration (even if the statutory time limits have been met). He found that there was maladministration in the case of Mr Hall [L00363], where there was an eight-day delay (from the date of receipt of cleared funds) in investing funds, and

in the cases of Mr Lavender [J00119] and Mr Nuthall [G00543], where there was a delay in investing additional voluntary contributions.

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