FRESHFIELDS BRUCKHAUS DERINGER

February 2004

BRIEFING

# Late payment of pension contributions by employers

Employment, pensions and benefits: briefing 106

**Executive summary**

This briefing looks at the consequences if employers pay contributions late to pension schemes. In particular, it looks at the sanctions imposed and whether any sanction is imposed in practice where contributions are paid only a few days late.

## Schedule of contributions

Occupational pension schemes which are subject to the minimum funding requirement (MFR) must maintain a schedule of contributions. The main relevant provisions are set out in sections 56 to 59 of the Pensions Act 1995 and the Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996 (the MFR Regulations). If an amount specified in the schedule of contributions is not paid on the due date, it is enforceable by the trustee as a debt.

It will also count as an asset for valuation purposes (eg for an MFR valuation) unless the trustee takes the view that it is unlikely to be recoverable without disproportionate cost or within a reasonable time.

Where contributions under the schedule are paid late, there is an obligation on the trustee to notify the Occupational Pensions Regulatory Authority (Opra) within 30 days. However, there is a limited exception in the legislation. If contributions are less than 10 days late on one or two occasions in a 12-month period the trustee is not required to make a report to Opra. On a third or subsequent occasion, the trustee must make a report to Opra.

Opra has said, in *Contributions – when Opra expects trustees to report late payment of contributions* (Update 5, January 2004), that in a multi-employer scheme it will treat payments of contributions by each employer separately when considering whether or not there has been a breach of the legal requirements. Opra has indicated to us that where there is a breach by, say, three employers at the same time (eg because of a group payroll failure) it may treat this not as three late payments by the scheme (which would be reportable) but as one late payment by each employer for this purpose (each of which would not on its own be reportable).

Opra also indicated in Update 5 that it did not in fact require trustees to notify some late payments of contributions (see the section on Seriousness of default? below).

In addition, if a payment is overdue by more than 60 days, the trustee must give notice to the members within 90 days of the due date. In a multi-employer scheme, the obligation to notify the members of contributions which are more than 60 days late applies only to members whose pensionable service under the scheme is with the employer who is in default. (It is not clear whether this includes pensioners and deferred pensioners.)

The trustee can be subject to a civil penalty under section 10 of the Pensions Act or, under section 3, prohibited from being a trustee if it fails to notify Opra and, where necessary, members (see above) or if it fails to prepare a report under section 59(3) of the Pensions Act where it appears to the trustee that the MFR may not be met.

The schedule of contributions will also include details of member contributions payable to the scheme.

## Payments schedule

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 MFR and so will not maintain a schedule of contributions. Instead it is obliged to maintain a 'schedule of payments' setting out details of the agreed contributions.

Broadly similar obligations apply to a payments schedule and a schedule of contributions if there is a failure to pay by the due date. Amounts unpaid are a debt and the trustees are obliged to notify Opra and all the members in much the same way. (It seems that all members must be notified even if only one member was affected by the late payment.) In contrast, however, to the position regarding a schedule of contributions, here there is no easement where the failure is the first or second in a 12-month period. Moreover, the obligation to tell members arises after 60 days (not 90) even if the contributions were in fact paid before then.

## Personal pensions/stakeholder pensions: direct payment arrangements

Where there is a direct payment arrangement by employers to a personal pension or a stakeholder pension scheme the employer must maintain a record of the direct payment arrangements showing the rates and due dates of contributions payable.

If any contribution shown by the record to be payable is not paid on or before its due date, the scheme provider must notify Opra within the 30-day period and notify members if payment has still not been received after 60 days. Opra has said (see Opra Note 8, February 2001) that the provider must report to it even if payments are only one day late on one occasion, or even if a partial payment is made before the due date. Failure to report the breach to Opra may incur a civil penalty.

The Pensions Bill 2004 envisages changing the obligation on providers and also adding a new obligation on employers to provide information to providers.

## Member contributions

An employer must pay to an occupational pension scheme contributions which have been deducted from members' pay before the 19th of the month following the month when they were deducted from pay.

It is an offence, under section 49 of the Pensions Act, for a person knowingly to be concerned in the fraudulent evasion of this duty by an employer. Since 3 April 2000 only fraudulent evasion, and not also a simple negligent failure, has been criminal. Opra recently brought a successful prosecution against a company director for fraudulent evasion[1].

An employer that fails to pay member contributions within the prescribed time may be subject to a civil penalty levied by Opra under section 10 of the Pensions Act. The maximum civil penalty under section 10 is currently £5,000 for an individual and £50,000 for others.

## Seriousness of default?

Opra takes late payment of member contributions very seriously but acknowledges that 'clerical hiccups' can occur. In practice, it is less likely to impose a penalty where the problem is rectified quickly and steps are taken to prevent recurrence.

Opra's Update 5 (see above), containing new guidance for trustees on reporting late payments of pension contributions to occupational schemes, explains when trustees should report late contribution payments to the pension scheme by the employer.

In keeping with its new risk-based approach, Opra expects reports only where there is a significant risk to members' interests. In Update 5, Opra says that it no longer wants reports of:

- isolated late payments of contributions, where the matter has been put right and action has been taken to prevent late payment from occurring again; or
- short periods of lateness of small amounts of contributions.

Given that there is a statutory obligation to tell Opra, the fact that Opra no longer wants the reports is not strictly a defence. In practice it is difficult to see that any sanction would apply if a trustee failed to give such a report. However, Opra indicates that trustees should continue to report contributions that are outstanding for 90 days or more. They should also report late contributions that may indicate further problems such as an employer's inability to pay, or misuse of contributions.

[1] Re: Peter Lavender was fined on 4 September 2003 at Gloucester Crown Court. Details of legal action taken by Opra for non-payment of contributions can be found at www.opra.gov.uk.

Employers are still required to pay contributions by the legal deadlines and must inform members where they do not pay contributions within 60 days of the due date.

Note that Update 5 does not apply to personal pension or stakeholder schemes, where the more stringent requirements remain.

The Pensions Bill envisages changing the reporting obligations on trustees for both schedules of contributions and payments schedules. The new requirement will be to report a breach only if it is of material significance (as to which the new Pensions Regulator will issue guidance in a code of practice).

## 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, in effect, 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. The section 40 prohibition does not apply if the amounts owing are due under the schedule of contributions or payments schedule.

## Money purchase benefits

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

The Pensions Ombudsman has held in at least two 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 case of *Mr Lavender* [J00119] 29 September 1999, where there was a delay in investing additional voluntary contributions[2].

[2] See also *Mr Banner* [L00213] 18 July 2003 regarding non-payment of contributions and *Mr Shelton* [K00611] 8 June 2001 where member contributions were not deducted; in both cases maladministration was found.

For further information please contact

David Pollard
T +44 20 7832 7060
F +44 20 7832 7001
E david.pollard@freshfields.com

Catherine McAllister
T +44 20 7832 7742
F +44 20 7832 7001
E catherine.mcallister@freshfields.com