

# Introduction to Stakeholder Pensions

## What is a Stakeholder Pension?

The government wants people who can save for retirement to do so. Stakeholder pensions are designed for people without access to employer sponsored pension arrangements. They are secure, flexible and offer value for money. They will provide the opportunity for many more people to save for retirement in a way they can afford.

## Stakeholder Pensions defined

The legal requirements for stakeholder pensions are included in the 'Welfare Reform and Pensions Act 1999' and 'The Stakeholder Pension Schemes Regulations 2000' - SI 1403'.

- To qualify as a stakeholder pension, a pension scheme must satisfy a number of minimum conditions:
- it must be a money purchase arrangement;
- management charges in each year must not amount to more than 1% of the total value of the fund and are taken from the fund;
- as well as the 1%, the law allows pension providers to recover costs and charges they have to pay for certain other things. For example, when they have to pay any stamp duty or other charges for buying and selling investments for the fund, or for particular circumstances such as the costs of sharing a pension when a couple divorce. These expenses are found in other pension schemes not just stakeholder pensions.
- any extra services and any extra charges not provided for by law must be optional. Extra services must be offered under a separate arrangement with clearly defined costs for the services being offered;
- the scheme must accept transfers in, and there must be no additional charge for transferring to a different stakeholder pension;
- the minimum contribution to a stakeholder pension cannot be set higher than £20 (schemes may set a lower minimum contribution if they wish). Contributions can be paid weekly, monthly (or at other intervals), or they can be a single one-off contribution;
- to look after the interests of their members, schemes must have either trustees or stakeholder managers;
- for trust-based schemes, a third of the trustees must be independent;
- schemes must appoint a scheme auditor or a reporting accountant to check the annual declaration made by the trustees or managers to ensure that the scheme complies with the charging regulations;
- schemes must have a statement of investment principles;
- schemes must have a default investment option.

## Who should take out a stakeholder pension?

Stakeholder pensions could be a good option for people who currently earn more than around £10,000 a year. However, they will be available to almost everybody, including people in employment, fixed contract workers, the self-employed and people who are not actually working but can afford to make contributions. It's also possible to contribute to someone else's stakeholder pension - for instance someone can make contributions to their non-working partner's stakeholder scheme on their behalf.

## How much can be invested in a stakeholder pension?

It is possible to invest up to £3,600 (including tax relief) in a stakeholder pension scheme each year without evidence of earnings. People can contribute to a stakeholder pension scheme even if they are not earning (up to the £3,600 a year maximum). However, under certain circumstances the maximum level of pension contributions may be increased for people with earnings according to their age and earnings level.

People who are already a member of an occupational pension scheme may also pay up to £3,600 a year into a stakeholder pension scheme, providing they satisfy certain criteria.

#### Trust schemes and non-trust schemes

Stakeholder pension schemes can be set up under a trust (where a body of trustees is responsible for managing the scheme) or can be set up by deed poll. Where the scheme is set up by deed poll, the manager of the scheme (the "stakeholder manager") may enter into contracts with each member of the scheme or a person acting on their behalf. The stakeholder manager could be an insurance company, bank, building society and must be authorised by the Financial Services Authority (FSA) to carry out stakeholder business.

### REGULATION OF STAKEHOLDER PENSIONS

#### The register of stakeholder pensions

Schemes which satisfy the registration conditions and have tax approval from the Inland Revenue must be registered with OPRA, the Occupational Pensions Regulatory Authority.

The register of stakeholder pension schemes is available on the OPRA website

OPRA is responsible for enforcing the conditions that define a stakeholder pension and allow it to be registered.

OPRA can fine trustees and providers for falling short of the conditions. In extreme cases it can withdraw stakeholder registration and order the winding-up of the scheme.

#### Financial Services Authority (FSA)

The FSA regulates the marketing and promotion of all schemes including any occupational pension schemes that are set up as stakeholder pension schemes.

#### Financial advice on stakeholder pensions

Any extra charges for provision of advice on stakeholder pensions must be entirely optional. Any charge levied for advice over and above the 1% stakeholder charges limit must not be deducted from pension contributions and should be entirely separate from the scheme charging structure. Financial advisers must keep to the rules laid down by the Financial Services Authority (FSA) and must state which organisation regulates their work. OPRA and the FSA will liaise closely, to ensure that stakeholder schemes are run according to the rules.

### TAX AND NATIONAL INSURANCE

#### Tax relief

There will be tax relief on any payments into a stakeholder pension. An employee's contribution to a Stakeholder Scheme will normally be made out of net income (i.e. income, after tax has been deducted by the employer). The Inland Revenue will send the amount deducted direct to the trustees or stakeholder pension scheme manager.

People who pay income tax at the higher rate (40%) will be able to claim back the tax difference from the Inland Revenue at the end of the tax year through self assessment To find out more about stakeholder pensions and tax, please see leaflet PSO2 Personal pensions (including stakeholder pensions) - a guide to tax

#### Contracting out

If an individual contracts out of the State Earnings Related Pension Scheme (SERPS) using a stakeholder pension plan, a rebate of National Insurance contributions is paid into their stakeholder plan.

### STAKEHOLDER PENSIONS IN THE WORKPLACE

#### Employers and stakeholder pensions

Employers who are not exempt must designate and offer access to a stakeholder pension scheme. If any employees join the designated scheme, the employer must offer a payroll deduction facility to those who want it. OPRA will be responsible for regulating the requirement for employers to give access to stakeholder schemes.

Employers must pay employee contributions to schemes within a specified timescale, and OPRA will be responsible for dealing with any reports of late payment of contributions by employers. If a stakeholder manager or trustee does not receive the expected amount from the employer on the date it is due, they have a statutory duty to report the matter to OPRA. OPRA will monitor reports of late payments and will take appropriate action against the employer where necessary.

## Monitoring by scheme managers or trustees

Stakeholder managers or trustees will be required to monitor that payments made by the employer or deducted from employees' pay are for the correct amount and are paid in on time. Employers will need to maintain payment records and inform the trustees or stakeholder manager of any changes. Any late payments, non-receipt of payments, or reduced payments by the employer that are not explained must be reported to OPRA. OPRA will then consider taking action.

## Penalties

Employers may incur a civil penalty from OPRA if they fail to:

- prepare a record of the payment arrangements;
- keep the record up to date;
- send the record to the trustees or stakeholder manager;
- inform the trustees or stakeholder manager of any amendments/changes;
- make correct payments by the due date.

The maximum fine possible is £50,000 for a company or £5,000 for an individual.

Where there is fraudulent intent, the penalty may be criminal.

OPRA states that it is less interested in punishing people than in getting things done correctly. Inadvertent mistakes are unlikely to be punished if they are put right promptly.

## Exemptions

The legislation includes a number of instances where employers are exempt from the requirement to provide access to a stakeholder pension scheme. The exemptions apply:

- to employers with fewer than five employees (this exemption will be subject to review after 3 years);
- where an employer offers a personal pension that satisfies certain criteria ;
- where all employees earn below the National Insurance Lower Earnings Limit;
- to an employer who offers an occupational scheme which all staff are eligible to join within a year of starting work (except those aged under 18 or within 5 years of retirement).

## Does offering employees a personal pension exempt employers from having to offer a stakeholder pension?

An employer may be exempt if:

- it is a term of each employee's contract that the employer will contribute at least 3% of basic pay into a personal pension on the employee's behalf;
- he/she offers a payroll deduction facility to members of the scheme; and
- the scheme imposes no penalties on employees who transfer out of the scheme or stop making contributions.

Notes:

- (i) Employers' contributions can be conditional on the employee contributing the same amount.
- (ii) Employers can contribute more than 3% but cannot require an employee to pay more than 3% of basic pay (calculated before tax and National Insurance etc).
- (iii) Basic pay excludes commission, overtime and bonuses.
- (iv) For arrangements in place before 8 October 2001, matching contributions may be allowed at whichever rate has been agreed between employee and employer. An employer need not include the arrangement in the contracts of staff if he can demonstrate that he has behaved as though there is such a term in the contract.
- (v) The exemptions for personal pensions will be reviewed after three years.

## **Employees who are not covered**

Employers do not need to provide access to a stakeholder pension for:

- employees who can join an existing occupational scheme within 12 months of starting work with the employer (see above);
- someone who has been continuously employed for less than 3 months;
- an employee whose earnings have fallen below the National Insurance Lower Earnings Limit for one or more weeks within the last 3 months;
- an employee who cannot join their employer's occupational pension scheme because they are under the age of 18 or they are within 5 years of the normal pensionable age for the scheme;
- an employee who is ineligible to make contributions due to a restriction imposed by the Inland Revenue.

However, employers who are not required by law to provide access to a stakeholder pension may still wish to do so on a voluntary basis.

## **WHAT DO EMPLOYERS HAVE TO DO?**

### **Actions required**

The legislation requires employers to:

- designate a registered stakeholder pension scheme having consulted with relevant employees;
- provide employees and organisations representing them with basic information about the scheme;
- offer payroll deductions from an employee's earnings;
- maintain records of employee deductions and payments to the scheme.

## **DESIGNATING A STAKEHOLDER SCHEME**

### **Identifying a stakeholder pension scheme**

'Designation' is the term used to describe the process where an employer formally selects a stakeholder pension scheme which his or her employees are invited to join.

An employer can pick a scheme by:

- looking at the list of registered stakeholder pension schemes on the OPRA website;
- looking out for stakeholder pensions advertising;
- choosing a stakeholder pension scheme offered by a provider;
- using the services of an IFA or consultant to identify a scheme;
- choosing a scheme specifically for people in his or her type of business; or
- asking employees for their views.

Having identified a stakeholder pension scheme the employer must:

- make sure the scheme is on OPRA's register of stakeholder pensions; and
- consult with employees and their representatives about the choice of scheme.

When the employer has decided on a scheme they should formally record the decision and:

- tell employees which scheme is designated; and
- give staff information about the scheme.

Employers must designate at least one scheme which will allow all relevant employees to join. Employers can designate more than one scheme if they wish.

Employees may join any scheme, but can only request payroll deductions relating to the employer's designated scheme. Before choosing a registered scheme provider, employers should look at their payroll and accounting systems to assess how easy it will be to manage the deduction of contributions. If this is not going to be straightforward, it might be worth selecting a provider who can set up payroll deduction facilities as part of their service. Once a scheme has been designated, the employer has a responsibility to check periodically that the scheme is still registered with OPRA. However, an employer is not liable for the performance of the designated stakeholder scheme.

### **Consulting with employees**

The Welfare Reform and Pensions Act 1999 requires employers to consult with relevant employees and any organisations representing them before designating a scheme. The consultation process is not laid down in regulations, so the means of consulting employees is for the employer to decide. There may already be a formal consultation procedure established; employees may be given details at a meeting; or they may be sent information and then asked for their views before the employer makes a final decision.

Employers only need to consult 'relevant employees' - that is those who would be eligible to join the scheme.

Employers may also choose to provide additional information to employees, such as DSS or FSA leaflets.

### **Providing details of the scheme(s)**

Once an employer has chosen a registered scheme, they must give certain information to employees about the scheme. This must include the scheme name and address. It may also be helpful to supply a telephone number or other contact details. It's possible that the scheme may produce its own literature that could be used for this purpose. Employers may decide to allow the scheme providers to visit or contact employees in the workplace.

### **Time limits for designating a scheme**

Employers who have five or more staff for at least three months up to 8 October 2001 must designate a stakeholder pension scheme by 8 October. Employers whose staff numbers increase to five or more during the three months prior to 8 October will have three months to comply from the date at which their staff numbers reach five or more. After 8 October, an employer who was previously exempt will have three months to comply from the time when he or she becomes liable under the regulations. An employer who ceases to be liable and then becomes liable again, will have three months to designate a scheme from the point of becoming liable once more. For example, an employer with six employees is liable to comply, however if two people leave then the employer no longer has to comply. If the employer subsequently hires a further person they will once again be subject to the requirement.

If the employer decides to withdraw from the designated stakeholder scheme they must designate a new scheme before withdrawing from the previous one. If the employer's designated scheme has its stakeholder registration withdrawn, the employer will have four months to designate a new scheme.

### **Provision of advice**

An employer can provide help and guidance, give additional information or interpret the information, but should be careful not to advise employees. The provision of financial advice is strictly controlled by the FSA.

#### **Employees wishing to join a different scheme**

If an employee is unhappy with the designated scheme, they can choose their own scheme; but in this situation individuals will be responsible for making their own payments to the chosen scheme. If a new employee is already contributing to a different scheme they can continue to pay the provider themselves, or transfer to the employer's designated scheme in order to benefit from payroll deductions. If requested by the employee, the employer must deduct contributions from the employee's salary for payment into the designated scheme, or any previously designated schemes to which at least one employee is still contributing. However, they may choose to help their employees by paying into any scheme of the employee's choice.

## **DEDUCTING CONTRIBUTIONS FROM EMPLOYEE SALARIES**

### **Contributions to a stakeholder pension**

Where an employer provides access to a stakeholder pension, they must also offer the facility to deduct employee contributions from pay. However, employees can choose to pay pension contributions direct to the scheme themselves.

### **Setting the level of contributions**

Employee contributions to a stakeholder pension scheme are voluntary. Once the employer has designated a scheme, employees wishing to contribute must individually decide how much they wish to contribute and how often.

The scheme is responsible for setting its own minimum contribution, but the law says that the minimum contribution cannot be set at more than £20. Contributions can be made weekly, monthly or at other intervals. One-off payments can be made at any time.

The contribution amount deducted from pay can be a:

- fixed sum agreed between the employer, the employee and the scheme provider; or
- a percentage of pay.

Whether pay (for calculation purposes) includes additional elements such as overtime is at the employer's discretion. Stakeholder pension contributions must be deducted from employees' pay after tax, National Insurance and other compulsory deductions. Once an employer has designated a scheme they must continue to provide a payroll deduction facility for that scheme for any employees who have chosen to contribute to it - even if the employer later decides to offer a different stakeholder pension scheme.

### **Changes to the amount contributed**

When an employee joins an employer's stakeholder pension scheme, employers must explain the process and rules for employees requesting a change to the amount they contribute. No charge can be made for changes to the amount contributed to a stakeholder pension. The amount can be changed at the individual employee's request. However, an employee cannot request more than one change every six months - unless the employer agrees to more frequent changes. The employee can ask for payroll deductions to stop at any time.

If the employer refuses to accept the employee's request to change the amount contributed, then the employer must write to the employee and explain why. If the request has been refused because more than one change has been made within the last six months, then the employer should tell the employee when they can next request a change.

If an employee needs to change the amount contributed more frequently than every six months, it might be worth the employee paying into the scheme direct (rather than via the payroll). There must not be any charge if a person stops paying into their stakeholder pension.

### **Making sure the correct amount is deducted**

It is the employer's responsibility to ensure that the percentage of pay has been calculated correctly and forwarded to the scheme provider. The deduction is made from the employee's net pay, which is defined as pay after the deduction of tax, National Insurance and other compulsory deductions.

- If there is insufficient money to make the full deduction, then no deduction should be made.
- The Inland Revenue determines the maximum amounts that individuals can contribute into a pension fund.

The scheme administrator will make a claim to the Inland Revenue for tax relief at basic rate for all members. The members' tax refunds will be sent to the scheme administrator by the Inland Revenue. Higher rate taxpayers may claim the balance of tax relief due through self assessment.

### **Making payments to the scheme on time**

There are set time limits for paying over the employees' and any employer's contributions to the stakeholder pension scheme. The employer must pay over the employee's contribution to the scheme provider within 19 days of the end of the month in which the deduction was made. For example, deductions made in February will have to be paid by 19 March at the latest, regardless of the frequency of the deduction. Failure to do so is an offence, which could result in a fine. It would therefore be sensible to arrange a payment date early in the month. If the employer decides to contribute to the scheme, they can agree a separate payment date with the provider for the employer contributions.

The provider will use the payment record as a monitoring tool to ensure that the correct payments are made and that they are received by the due date. If the amount of employee contributions paid differs from what's shown on the payment record (perhaps the employee has decided not to contribute in a particular month), the employer must make sure that the provider knows why. It is an offence for an employer to breach these requirements, and a breach could result in the employer being fined by OPRA or even taken to court.

### **Payment methods**

There are no defined methods of payment. It is for the employer and the scheme provider to agree the method.

Payment methods to the scheme could include:

- cheques sent direct
- direct credit
- direct debit
- Internet facility, using direct debit.

Providers are permitted to refuse to accept payments in cash or by credit card.

### **Record Keeping**

Record keeping is a key part of the deduction arrangements. The employer must keep up-to-date records of the amounts and dates of contributions from employees and the employer. This record enables the scheme provider to monitor that the correct payments have been made and that they have been made on time. There is no pre-defined method of providing employee information relating to the payment. The employer and provider can agree a mutually satisfactory method of achieving this. The employer should confirm the recording arrangements in conjunction with the scheme provider.

Once the amounts of contributions are agreed, the details which must be recorded include:

- employer's name;
- scheme contracted out number;
- employee's name(s);
- employee's National Insurance number;
- amount of contribution by the employee;
- dates when the contribution is to be deducted from the employee's pay (frequency);
- date of payment to the trustee/scheme manager;
- employer contribution (if appropriate) - this should be shown separately;
- due date for employer's contribution.

After the completion of the record, the employer must send a copy to the scheme provider who will monitor the arrangements. If there are changes to the amount originally agreed, the record must be updated and sent to the provider by the first due date on the record following the change. If individuals are added to or removed from the payroll deduction facility, the details should be noted on the record and sent to the provider by the first due date on the record.

**This fact sheet is an outline of the position at the time of writing.**

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