Automatic enrolment in workplace pension schemes

Guidance on the regulatory framework

DWP Department for Work and Pensions

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Chapter 1: Introduction

1. There is growing evidence that using automatic enrolment (sometimes referred to as 'negative affirmation' or 'opt-out') is one of the most effective ways of increasing levels of workplace pension scheme membership.

2. We are aware, however, of concerns within the financial services industry that it is perceived as difficult, under the current regulatory regime, to use automatic enrolment in the context of employer-arranged Group Personal Pensions (GPPs) and group stakeholder pensions (SHPs). We are publishing this guidance to address those concerns. The guidance sets out the Government's view of the circumstances in which auto-enrolment into workplace GPPs and SHPs can be used within current regulations.

3. Except where stated, the issues covered by this guidance are relevant in the context of workplace GPPs and SHPs only and not occupational pensions.

4. This guidance is intended primarily to advise businesses, and their legal advisers or representatives, of the main regulatory issues they need to be aware of when using automatic enrolment techniques in the workplace. It should not be regarded as a substitute for, or definitive interpretation of, the laws and rules referred to below, and should be read in conjunction with them and taking into account obligations which may arise at common law. This guidance does not refer to all relevant Financial Services Authority rules and authorised firms remain responsible for compliance with these rules.

5. This guidance has been agreed with HM Treasury, HM Revenue and Customs and the Department for Trade and Industry. We have consulted with the following organisations in the preparation of this guidance: the Financial Services Authority, the Association of British Insurers, the National Association of Pension Funds, the Society of Pension Consultants, the Association of Independent Financial Advisers, the Confederation of British Industry and the Trades Union Congress.

Chapter 2: The Distance Marketing of Consumer Financial Services Directive

1. Directive 2002/65 concerning the distance marketing of consumer financial services (the Directive) is frequently cited as a possible regulatory barrier to the use of automatic enrolment techniques for workplace personal pensions. The Directive was implemented in the UK, with effect from 31 October 2004, by the Financial Services (Distance Marketing) Regulations 2004 (SI 2004/2095) and by the Financial Services Authority's (FSA's) Conduct of Business rules.

2. The aim of this Directive is to provide consumers with protection where financial services are sold to them at a distance.

3. The Directive sets common minimum standards for the information that must be given to consumers of financial services before a distance contract is concluded. This means ensuring the consumer knows certain facts about the supplier and the supplier's charges, among other things.

4. The Directive's common standards apply only where the supplier of the financial service uses exclusively one or more means of distance communication, such as telephone, internet, email, fax or mail.

5. Because the consumer in a distance contract is reliant on information provided by a supplier at a distance, the consumer is given rights to cancel the agreement without penalty.

6. These are important protections and nothing in this guidance is intended to diminish the level of consumer protection provided by the Directive.

7. In our view it is possible for suppliers and employers to establish and operate automatic enrolment into workplace Group Personal Pensions (GPPs) and stakeholder pensions (SHPs) while at the same time ensuring that employees, who are for these purposes, also consumers, receive the protections to which they are entitled under the Directive.

8. The remainder of this part of the guidance looks at some of the main aspects of the Directive of which those contemplating using automatic enrolment techniques need to be aware.

Distance contracts

9. The first point to make clear is that the Directive and implementing rules only apply to contracts that have been arranged at a distance, i.e. where **all** the stages prior to conclusion of the financial services contract involve **exclusively** distance means of communication such as letters, emails or telephone calls.

10. Where there has been **any** element of meaningful face-to-face communication between the supplier, the supplier's representative or intermediary and the employee about the GPP or SHP, then there will be no distance contract and the requirements of the Directive and implementing rules will not apply.

11. An employer who takes some steps to promote or encourage or facilitate the enrolment of employees into a GPP or SHP is likely to constitute an intermediary[1] for the purposes of the Directive and implementing rules. Financial advisers who are involved in any part of the marketing of the GPP or SHP, to the employees are also likely to be intermediaries for the purposes of the Directive and implementing rules.

12. Face-to-face communication includes the following:
    - a one-to-one meeting at which information about the pension scheme is given by the supplier/intermediary to the employee; or
    - a presentation about the pension scheme by the supplier/intermediary to a group of employees.

13. In our view, there will still be a communication even if the employee does not ask any questions or enter into discussion with the supplier/intermediary. There will be no distance contract where the supplier/intermediary orally provides information face-to-face with the employee. Whatever form the non-distance communication takes, the supplier/intermediary should keep a record of the employees attending so as to have a clear record of those employees who, if they enter into contracts with the supplier, will not be entering into distance contracts.

Unsolicited supply of services

14. If a consumer has not previously requested a financial service to be supplied at a distance, under the Directive and implementing rules the consumer will not have any obligations under the resulting contract (Article 9 and Regulation 15).[2]

15. If unsolicited financial services are supplied to a consumer at a distance and the supplier includes a demand for payment the supplier will be guilty of an offence.

1 This is not the same as 'insurance intermediary' in the FSA's rules.

2 Legal advisers will wish to note that this prohibition on unsolicited supply of services has now been subsumed within the broader prohibition on 'inertia selling' in the EU Unfair Commercial Practices Directive which was adopted in June 2005 and is to be implemented in the UK by June 2007.

16. The point to stress here is that the offence only arises where a demand for payment (or a statement that payment is due) is made by the supplier together with the unsolicited supply.

17. Automatic enrolment into a workplace personal pension without a previous request from the employee but where only the employer contributes **will not** give rise to an offence. However, even if only the employer makes a contribution, if the supply has not been requested by the employee, then the employee will not have any obligations under the contract.

18. If the employee makes a request for the financial services then there will be no offence and the employee will have obligations under the contract. The request could take one of several forms, for example a tear-off slip on a scheme announcement letter which the employee could sign.

19. Alternatively the request could appear as a clause in the employment contract.

20. The request would need to include the following:

    - that the employee agrees that the employer (acting as their agent) may enrol them into a GPP or SHP but only after the employee has received the essential terms of the financial services contract, including:
        - the name of the supplier of the GPP or SHP; and
        - details of the employee's right to opt out of membership by a certain date.
    - that if the employee does not opt out, deductions from their pay will be paid over to the supplier by way of the employee's contributions to the GPP or SHP; and
    - the amount of the employee's contribution (or that the employee will be told the amount at a later date but in good time before the conclusion of the financial services contract).

    Such a clause could be along the following lines:

    > 'By signing this section of the contract, [the employee] agrees that [the employer] will act on their behalf in taking the steps necessary to enrol [the employee] in [the company's group personal pension scheme/group stakeholder pension scheme] (the Scheme). [The employee] hereby declares that they wish [the employer] to take those steps on their behalf. [The employer] undertakes that they will not enrol [the employee] into the Scheme before [the employee] has received the essential terms of the contract, including in particular the name of the supplier of the Scheme, details of the right of [the employee] to opt out of membership of the Scheme by a specified date, and details of the amount, or date by which they will be informed of the amount of contributions that [the employee] would pay to the supplier by way of deductions from their wages under the Scheme.'

21. Some suppliers have expressed a concern that the FSA's rules put the burden of proof on the supplier to keep records of employee consent forms. This concern arises only where the FSA is considering a potential breach of its rules. In this instance, there is no FSA rule on contractual consent. The issue is one of contract law. Suppliers will need to ensure that they are confident that proper employee consent has been given. In addition, a supplier will need to take reasonable steps to ensure that the employee will have had a proper opportunity to consider the terms, such as by:

   - providing all relevant information to the employer;
   - discussing with the employer its systems; its approach to passing on this information and providing adequate time before concluding the contract; and
   - responding properly to any complaints or concerns that may arise.

22. Even if the supply is solicited, the information and cancellation requirements of the Directive and implementing rules (see below) may still apply if the pension contract is a distance contract.

Prior information requirement

23. Under the Directive and implementing rules, the supplier is required to give the consumer all the relevant contract information in a durable medium, such as on paper or on CD, in good time before the consumer is bound by a distance contract.

24. Suppliers have raised two issues here:

   - when the pre-contractual information (i.e. Key Features Documents/Decision Trees, etc) should be sent; and
   - what actually constitutes the conclusion of a contract for membership of a GPP or SHP when arranged by automatic enrolment?

25. The Directive and implementing rules require the pre-contractual information to be provided in good time before the customer is bound, i.e. before the contract is concluded. The term 'in good time' is not defined in the Directive, so must take its ordinary and natural meaning. In our view this means the employee should be given adequate time to pause and reflect, and to assess the suitability of the contract, before deciding whether or not to enter into the contract.

26. Our view is that a pension contract is concluded when the employee's consent is in fact conveyed to the provider. When this happens will depend on all the particular circumstances of the case, and suppliers will need to take individual advice on the contract wording and timing arrangements for each automatic enrolment scheme.

27. Where cancellation rights exist the Directive and implementing rules provide consumers with a right to cancellation (usually 30 days) following the conclusion of the contract without penalty and without having to give a reason.

Chapter 3: Financial promotions

1. Some employers have raised concerns about the provisions of the Financial Services and Markets Act 2000 (Financial Promotions) Order 2001 and the effect of those provisions on any communications (distance or otherwise) between employers and employees in relation to Group Personal Pensions (GPPs) and stakeholder pensions (SHPs).

2. On 1 July 2005 the Government amended the Financial Services and Markets Act 2000 (Financial Promotions) Order 2001 to make it easier for employers to promote the uptake of their pension schemes by their employees.

3. The changes relate to employer-arranged GPPs and SHPs, but only if the employer makes a financial contribution to the pension they are promoting, and only if the employer does not receive a direct financial benefit from promoting the uptake of these pensions. More details on these and on other conditions are explained below. Other types of pension are not affected by these changes.

4. A new exemption was provided in this Order which enables the employer to make such financial promotions without needing to be authorised by the Financial Services Authority (FSA), and without such promotions needing to be approved by a person who in turn has been authorised by the FSA.

5. The new exemption applies to all types of promotion, both oral and written, although any written promotional material about the scheme must inform the employee of their right to seek independent financial advice from a person authorised by the FSA. It would be good practice to tell employees of this during oral promotions as well.

6. As long as the conditions set out in the new Order are complied with, the new exemption places no legal restrictions on the types of promotional material which the employer's representative may provide; for example, whether the employer's representative decides to provide generic advice about the benefits of taking up a pension in general, or whether the representative provides individual employees with tailored financial advice about how they should manage their personal finances given their specific circumstances.

7. In practice, given the need for the employer's representative to be competent and knowledgeable, it is likely that the vast majority of representatives will not be in a position to provide individual employees with specific and personal financial advice.

8. It is likely that most employers' representatives should, however, be in a position to explain to employees exactly how they individually would benefit from taking up the pensions being promoted.

9. The promotion must be made by someone who is employed directly by the employer, but no other restrictions apply on who the representative might be. The exemption does not apply to third parties who might be acting on the employer's behalf, for example the pensions administrator where the employer has outsourced this function.[3]

10. The employer must make sure that the representative possesses sufficient competence and knowledge of the pensions they are promoting. There are no restrictions or requirements on how this competence and knowledge should be developed. There are no formal training, competence or accreditation criteria, and no restrictions or requirements placed on who might advise the representative.

11. The exemption only applies if the employer makes a financial contribution to the pension they are promoting. There are no minimum requirements on the size of the financial contribution, but employers are required to disclose the size and nature of their contribution.

12. This disclosure must be made in writing before the employee takes up the pension, and should explain to the employee how much the employer is contributing to that employee's pension, rather than how much they are contributing to the pension scheme as a whole. But there are no restrictions on how this might be expressed – it could be expressed as a percentage (for example 5 per cent of the employee's salary) or in terms of particular sums (for example £100 a month).

13. The employer must also not receive a direct financial benefit from promoting the uptake of pensions. In particular, they must not earn a commission or equivalent form of financial reward as a result of employees taking up pensions which they have promoted. An equivalent form of financial reward would include any reduction in the amount of premium payable which the employer pays in relation to any insurance policy issued to the employer by the provider of the pension scheme.

3 However, the prohibition against financial promotion does not apply to persons who are authorised by the FSA, and therefore if a promotion is made in the workplace by an authorised person, such as the supplier of the GPP/SHP, then that person will not need to comply with the terms of the exemption (they will be subject to the FSA's rules).

Chapter 4: Contract law

1. We are aware of some uncertainty as to how a valid pension contract can be established between an employee and a supplier without the employee giving the supplier their written consent to entering into the contract.

2. In our view, the employee can authorise the employer to act as their agent to enrol them into the Group Personal Pension (GPP) or stakeholder pension (SHP). But in order to create a valid contract the contracting parties (in this case, the supplier and the employee) must have knowledge of the essential terms of the contract prior to entering into it. Therefore the employee's authorisation should state that the employer is not to enrol the employee into the GPP or SHP until the employee has received the essential terms of the contract. The essential terms will include the amount of the employee's contributions. Suppliers will also need to comply with Financial Services Authority (FSA) rules that require specific pre-contractual information to be provided to consumers.

3. This authorisation could be included as a term of the employment contract (see Chapter 2, paragraph 20 for a draft model employment contract clause). In the Government's view, this term, if included in the employment contract, should be made clear to the employee. It should be put in a separate section of the employment contract and the employee should be required to sign that separate section. The reason for this is that it will bind the employee to the contract with the supplier and therefore to payment of contributions to the supplier. For existing employees the authorisation could take the form of a separate agreement or addendum to the employment contract. This term would also serve to avoid the contract being unsolicited, in the ways described in Chapter 2, paragraphs 14–22.

Chapter 5: Employment law

1. Under the common law the terms of a contract of employment cannot be unilaterally varied, for instance to impose automatic enrolment into a pension scheme. Moreover, section 13 of the Employment Rights Act (ERA) 1996 stipulates that a deduction from a worker's wages is unlawful unless either: (a) the deduction is required or authorised to be made by virtue of any statutory provision or any relevant provision of the worker's contract (if it is required or authorised by any relevant provision of the worker's contract, the worker must have been given a written copy of any relevant contractual term or a written explanation of it before the employer makes the deduction in question), or (b) the worker has previously signified in writing their agreement to the deduction.

2. Additionally, under section 14(4) of the ERA 1996, where a deduction is made under an arrangement agreed to by the worker, in writing, for the employer to pay to a third party, amounts notified by that third party as being due to them from the worker, the deduction is lawful. This covers deduction of pensions contributions to be paid to third party pension scheme providers. Arrangements 'agreed to in writing' mean (a) arrangements set out in the contract and to which the worker has given written consent, or (b) arrangements established with the worker's prior consent signified in writing.

3. This means that in order to enrol existing employees automatically it would be necessary **either**:

   - to arrange for their employment contract to be changed, which would require the agreement of the employees individually or by collective bargaining agreement where arrangements exist. In either case, where deductions are to be paid to the employer it would still be necessary for each employee to be given a written copy of the term or terms which authorise deductions before they are made. If the change to the contract provided for deductions to be paid to a third party, each employee would have to consent in writing to the term in the contract making that change; **or**
   - to obtain the employees' separate written agreement to deductions (or, where relevant, the payment of deductions to a third party) being made from their pay; there would then be no need arising under the ERA 1996 for their contracts to be changed.

4. Note that collective bargaining agreements can only vary individual employees' contracts of employment where those contracts provide that collective agreements, as from time to time in force, including new or amended agreements, form part of the contract of employment.

5. This law affects automatic enrolment into all types of workplace pension – both occupational and personal.

Chapter 6: Data Protection Act 1998

1. Before an employer shares details of employees (for example names, addresses, National Insurance numbers) with a pension provider, they should obtain the written consent of the employees. As with the Employment Rights Act 1996 this agreement could take the form of a separate written agreement or be covered by a suitable clause in the employment contract.

2. We understand that pension providers factored this into their joining processes before the introduction of the Distance Marketing of Consumer Financial Services Directive (the Directive), but some have been concerned about the burden of proof with this requirement. This is a similar issue to that relating to the 'prior request' under the Directive – see Chapter 2, paragraphs 23–27.

3. A possible clause in the employment contract on this point could be along the following lines:

   '[The employee] further agrees that [the employer] may disclose their name, address, gender, date of birth, National Insurance number, and dates of commencement of employment and joining the Scheme to the nominated supplier under the Scheme, for the purpose of facilitating supply and administration of the Scheme to [the employee].'

Chapter 7: Tax relief at source regulations

1. HM Revenue and Customs' (HMRC) tax relief at source regulations (the Personal Pension Schemes (Relief at Source) Regulations 1988 (SI 1988/1031 as amended by SI 2000/2315) are regarded by some in the pensions industry as a potential barrier to the use of automatic enrolment into workplace personal pension schemes, both Group Personal Pensions (GPPs) and stakeholder pensions (SHPs), because they require the active involvement of employees in providing their pension provider with a) certain information and b) certain declarations and certificates.

2. HMRC will be introducing new relief at source regulations (the Registered Pension Schemes Relief at Source Regulations 2005) to take account of the new simplified regime for the taxation of pensions that comes into effect on 6 April 2006. A draft of these regulations has been published and can be viewed at http://www.hmrc.gov.uk/pensionschemes/relief_at_source4.pdf The Government will look to amend these draft regulations so that from 6 April 2006 they do not inhibit automatic enrolment by employers.

3. The current regulations for relief at source require a member to provide certain information and make certain declarations to the pension scheme administrator in order to pay contributions net of basic rate tax. Some of the information will be known by the employer, for example name, date of birth and National Insurance number; but other information will only be known after confirmation from the employee – for example whether or not the individual is paying contributions under other pension arrangements. If an employer wishes to obtain this information from an employee and, with the employee's consent, use it to make a declaration to the scheme administrator, then the declaration will comply with the existing regulations providing the scheme administrator complies with the requirement to confirm those details with the individual employee member, allowing them 30 days in which to make corrections.

Chapter 8: Money Laundering Regulations 2003

1. Part II 4 (3) of the Money Laundering Regulations 2003 states that as soon as reasonably practicable after contact is made between an applicant for business and a person/firm carrying out relevant business, satisfactory evidence of the applicant's identity must be produced. The risk of money laundering is deemed higher where the applicant is not physically present, and if satisfactory evidence is not obtained, the business relationship or one-off transaction must not proceed any further. This is reflected within the Financial Services Authority's (FSA's) *Money Laundering Sourcebook*. There is, however, some uncertainty as to how this applies to individual contributions into workplace pension schemes.

2. In accordance with the *Joint Money Laundering Steering Group (JMLSG) Guidance Notes 2003* Annex 1 to Section 4 – Pension Contracts, the money laundering risk is considered minimal if contributions are paid solely by the employer. Therefore the provider only has to identify the employer and not the individual in relation to Group Personal Pensions and stakeholder pensions. However, if the employee pays through their own bank account, by direct debit mandate, then employee verification is also required. Any third party payer must also be identified. A risk-based approach is taken in relation to these types of contracts.

3. Approved occupational pension schemes are exempt from the requirement to identify the source of payments if provided and administered by an insurer.

4. Identification must be undertaken as per the standard verification procedures set out under Section 4 of the JMLSG Guidance Notes – *Know Your Customer* and *Identification Evidence*.

Chapter 9: Further information

If you have queries about issues raised in this guidance you may wish to talk to your legal adviser. Further information about the legislation concerned is also available from the following sources:

The Financial Services (Distance Marketing) Regulations 2004 –
http://fsahandbook.info/FSA/handbook.jsp?doc=/handbook/COB/1/10

The Money Laundering Regulations 2003 –
http://fsahandbook.info/FSA/handbook.jsp?doc=/handbook/ML

The Financial Services and Markets Act 2000 (Financial Promotions) Order 2001 –
http://fsahandbook.info/FSA/handbook.jsp?doc=/handbook/AUTH/App/1
http://www.hm-treasury.gov.uk/documents/financial_services/pensions/finance_promoting_pensions.cfm

The Employment Rights Act 1996 – http://www2.dti.gov.uk/er/pay/contracts-pl810.htm

The Data Protection Act 1998 –
http://www.informationcommissioner.gov.uk/eventual.aspx?id=34

The Personal Pension Schemes (Relief at Source) Regulations 1988 and the Registered Pension Schemes Relief at Source Regulations 2005 –
http://www.hmrc.gov.uk/pensionschemes/relief_at_source4.pdf

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