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BRIEFING PAPER

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Brexit - implication for pensions

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Summary

The implications of the vote to leave the EU on 23 June are as yet unknown. This note brings together initial responses from relevant organisations. Other material will be added as it becomes available. A fuller analysis of the background issues in a wide range of areas can be found in a previous Library Note CBP-7213 EU referendum: impact of an EU exit in key UK policy areas (February 2016).

1. Private pensions

1.1 The legal framework

The design of pension systems is largely the responsibility of Member States. The regulatory framework at EU level covers:

- establishing an internal market for funded occupational pension schemes and the minimum standards to protect scheme members;
- minimum guarantees concerning accrued rights in occupational pension schemes in case of the insolvency of the sponsoring employer; and
- anti-discrimination rules.[1]

The Pension and Lifetime Savings Association (PLSA) explains that UK workplace pension schemes tend to operate on a national basis but want access to investment opportunities and service providers in the EU:

1. Workplace pension schemes in the UK are not generally looking to provide pensions to workers in other Member States. So, in this respect, there is little interest in taking up the opportunities that might - in theory at least – be provided by an effective EU-wide Single Market.
2. However, workplace pension schemes do want ready access to investment opportunities and service providers in EU and across the world, and this is where a strong Single Market has a role to play. Having ready access to the widest possible range of service providers helps schemes to invest their assets

[1] European Commission Memo 10/302 Green Paper on Pensions, July 2010; European Commission, Green Paper. Towards adequate sustainable and safe European pension systems, Brussels 7 July 2010, SEC(2010)830

> and administer their schemes with a minimum of cost in order to provide the best value to their members.[2]

EU legislation has an impact on them:

- directly, through pensions-specific EU legislation such as the Directive on Institutions for Occupational Retirement Provision ('IORP Directive'), through the regulatory activities of EIOPA, and through EU employment law, such as the Equal Treatment Directive; and
- indirectly, because the costs of complying with the EU's investment markets legislation (such as EMIR, MIFID, the draft Money Market Funds Regulation and the potential Financial Transaction Tax) are passed to pension fund clients by asset managers, brokers and banks.[3]

More detail about the legislation that currently applies is on the Europe and International section of the PLSA website.[4] Library Briefing Paper CBP-07435 Financial Services: European aspects (June 2016) brings together recent European legislative and regulatory developments in the sphere of financial or corporate regulations.

Regulators' statements following vote on 23 June

Following the vote on 23 June, the regulators explained that existing regulations would continue to apply until the UK Government changed it. The Financial Conduct Authority said:

> Much financial regulation currently applicable in the UK derives from EU legislation. This regulation will remain applicable until any changes are made, which will be a matter for Government and Parliament.
>
> Firms must continue to abide by their obligations under UK law, including those derived from EU law and continue with implementation plans for legislation that is still to come into effect
>
> Consumers' rights and protections, including any derived from EU legislation, are unaffected by the result of the referendum and will remain unchanged unless and until the Government changes the applicable legislation.
>
> The longer term impacts of the decision to leave the EU on the overall regulatory framework for the UK will depend, in part, on the relationship that the UK seeks with the EU in the future. We will work closely with the Government as it confirms the arrangements for the UK's future relationship with the EU.[5]

On 19 July, the new head of the Financial Conduct Authority Andrew Bailey said there would be no "great bonfire of regulations" – many were either stipulated on a global level or were laws the UK would in any case want to keep.[6]

The Pensions Regulator said:

> While all UK and EU pensions law currently applies as usual, we will continue to monitor the markets and other economic developments, and we will provide more guidance to trustees of both DB and DC schemes as necessary. Our operational approach remains unchanged.
>
> We will also continue to engage with European institutions such as EIOPA (European Insurance and Occupational Pensions Authority), while we wait for further clarity as to

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2 PLSA response to HM Treasury's review of the balances of competences: Single Market – financial services and the free movement of capital, January 2013. The PLSA was previously known as the National Association of Pension Funds

3 Ibid

4 See also: *'Playing by the rules',* PensionsAge July 2016

5 FCA Statement on European Union referendum result, 24 June 2016

6 'Financial watchdog calls for access to EU single market', *Financial Times,* 20 July 2016

> the nature of the UK's future relationship with the EU and any transitional arrangements.[7]

Initial comment

The PLSA said the ramifications would become clearer over the coming weeks and months. Much would depend on the precise nature of the UK's future relationship with the EU. It called for the Government to "act swiftly and decisively to manage current volatility and announce a clear plan to renegotiate our future relationship with the EU."[8]

Reports in the pensions press suggest many experts expected much of the existing EU-derived legislation to remain in place (partly because it was designed to protect members, for example against discrimination). There were questions about whether the Government would proceed with complex rules to require equalisation of Guaranteed Minimum Pensions. Otherwise, any legislative changes were likely to be in the longer term.[9]

Early indications were that new EU law passed before the UK exits would be incorporated into UK law, including the new Directive on institutions for retirement provision - IORP II – which is expected to be approved by the EU shortly and to require only relatively "modest changes in the UK." Controversial plans for a 'holistic balance sheet' approach to scheme funding having been dropped, the directive focuses on governance and member communications.[10]

A new EU General Data Protection Regulation is to apply from 25 May 2018 and will require some important changes. It is expected to apply automatically in the UK. There is an overview of the regulation on the Information Commissioner's Office (ICO) website. The ICO is also expected to issue guidance.[11]

1.2 Market volatility

The Association of British Insurers said customers should "avoid making hasty decisions about their financial matters." It called on the Government to focus on ensuring the UK remained a "globally competitive place to do business with the best possible future trading network with the EU and the wider world."[12]

The Pensions Regulator warned against "knee-jerk reactions" but said trustees should review their position to understand the risks in the scheme's investment strategy and employer covenant (their legal obligation and financial ability to support the scheme). The impact on employers would take time to become clear and would depend on their circumstances:

> Following the vote, there will be a period of transition and this uncertainty can be destabilising for employers. While it will be some time before the impact upon sponsoring employers of DB schemes becomes clear, some sponsors may be feeling the effects already and this can have a positive or negative impact on the covenant to the scheme.

7 TPR warns trustees against knee-jerk reactions to market volatility, 14 July 2016; Market volatility following the EU referendum: guidance statement from TPR

8 PLSA responds to the UK's decision to leave the European Union, 24 June 2016; See also PensionsEurope comments on the result of UK referendum on EU membership, July 2016

9 See, for example, 'How could Brexit affect pensions?' *Professional Pensions*, 21 June 2016; Brexit: experts look at the impact for pensions, *Pensions World*, 24 June 2016; 'Brexit: implications for pensions industry', *Occupational Pensions,* August 2016

10 'Brexit: implications for pensions industry' and 'Agreement reached on IORP II text', *Occupational Pensions,* August 2016; 'New EU pensions directive' – PLSA website.

11 'Brexit: implications for pensions industry', *Occupational Pensions,* August 2016; 'EU parliament approves tough new data protection laws', *Occupational Pensions,* June 2016

12 ABI comments on EU Referendum vote, 24 June 2016

> The impact on sponsors will be specific to the sector they are in. Even within sectors, it will be employer-specific depending on the nature of their business and strategy and exposures to the EU.
>
> Trustees should consider how exposed their employer may be to the various risks and opportunities which may come with the transition of trading relationships and potential changes in economic fundamentals, for example in the strength of sterling. This will give them a framework to consider the potential impact on covenant strength and to monitor the development of these factors.
>
> Trustees should have an open and collaborative discussion with the employer to understand their views and position, along with the impact of this for their risk appetite in respect of the scheme.
>
> There may be some nervousness around business investment while the impacts of the referendum become clearer and such undertakings may be put on hold or directed differently. Trustees should continue to ensure that where deficit repair contributions (DRCs) were constrained to allow for investment in sustainable growth of the sponsor, that it continues to be used to strengthen the covenant to the scheme rather than being diverted away from the covenant (for example to pay dividends).[13]

Trustees should consider with their advisers the extent to which volatility and changing market conditions affected the longer-term view of expected risk and returns:

> Volatility in market conditions could have a material impact on a scheme's funding position although the effect will depend on a number of factors including the extent of any hedging and the scheme's asset allocation. Trustees should not be overly focused on short-term market movements, but it is important to understand how this impacts on scheme funding plans and decision-making, including any issues with regard to liquidity and cash flow management. Trustees should consider with their advisers the extent to which volatility and changing market conditions affect the longer-term view of expected risk and returns, and how this interacts with the scheme's funding plans and risk appetite. Scenario planning may help with this assessment given the uncertainty of future economic developments.
>
> Where current conditions mean the scheme is exposed to an inappropriate level of risk, taking account of their assessment of the sponsor's covenant and other relevant factors, trustees should reconsider their investment strategy in that context. Where trustees decide that action is needed, they should consider carefully the timing for implementation and be in a position to take action when appropriate.[14]

Trustees of defined contribution schemes might want to make changes to default arrangements as the implications became clearer:

> The impact on DC members' savings will depend on where they are in their pension saving journey - they may be a long way from minimum pension age, approaching pension age, or already accessing some or all of their pension savings. Many schemes will already have strategies in place that are designed to minimise the impact of market movements on the funds of individual members who are close to pension age.
>
> As the future implications of any withdrawal from the EU become clearer, you may consider it appropriate to make changes to the investments included in the scheme's default arrangement, and/or other investments offered to members. You should work with your providers and advisers to monitor developments and take steps to manage any emerging risks to the scheme (eg impacts on charges). Remember that poor value for members is a key risk that trustee boards need to manage. [15]

Good member communications would remain vital to "help members engage and make decisions that lead to good outcomes in retirement."[16]

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13 Market volatility following the EU referendum: guidance statement from TPR, July 2016
14 Ibid
15 Ibid
16 Ibid

2. State Pensions

Long-standing rules enable the co-ordination of social security entitlements for people moving within the EU.[17]The rules also apply to EEA countries and Switzerland. They allow periods of insurance to be aggregated, so that an individual who has worked in other Member States can make one application in their country of relevance, which then arranges for each state where they were insured to pay a pension. They also allow for a pension built up in one Member State to be drawn in another. UK state pensioners resident in EEA countries also receive annual increases to their state pension. Elsewhere, the UK state pension is only uprated if there is a reciprocal social security agreement requiring this.[18] Outside of the EU, the UK could presumably seek to negotiate bilateral agreements with individual Member States, or an agreement with the EU/EEA as a whole.[19]

The arrangements that will apply in future will be considered as part of negotiations for the UK's exit from the EU.[20] On 8 July 2016, Leader of the House of Commons David Lidington said there would be no immediate change:

> Mr David Anderson (Blaydon): To ask the Secretary of State for Foreign and Commonwealth Affairs, what assessment he has made of the implications of UK withdrawal from the EU for UK pensions and healthcare provision for UK citizens (a) currently residing in other EU member states and (b) wishing to retire to other EU member states.
>
> Mr David Lidington*:* As the Prime Minister, my Rt Hon. Friend the Member for Witney (Mr Cameron) has said, there will be no immediate changes in the circumstances of British citizens living in European countries. It will be for the next Prime Minister to determine, along with their Cabinet, exactly the right approach to take in negotiating these provisions going forward but the Government's guiding principle will be ensuring the best possible outcome for the British people. [21]

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[17] Now in

[18] *Social Security Contributions and Benefits Act 1992*, s113; *Pensions Act 2014*, s20, See Library Briefing Paper SN01457 Frozen Overseas Pensions (May 2016)

[19] For more detail, see Library Briefing Paper CBP-07213 EU referendum: Impact of an EU exit in key UK policy areas (February 2016), p106-7

[20] PQ 37724, 27 May 2016; See also PQ HL 6342, 23 February 2016

[21] PQ41482 8 July 2016