



## BRIEFING PAPER

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# Brexit and Private Pensions

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## Summary

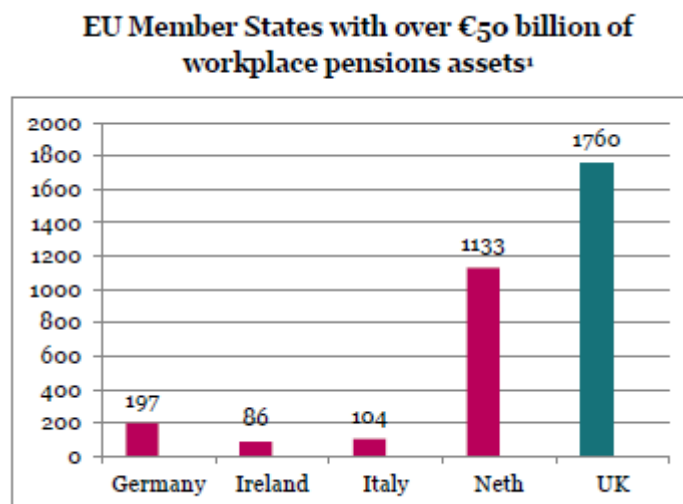
This note looks at the emerging discussion about the potential impact of Brexit on private pensions - occupational and personal pensions. Other issues are covered on the [Brexit: research and analysis](#) section of the Parliament website, including CBP-7894 [Brexit and State Pensions](#) (November 2018) and CBP-07628 [Brexit and financial services](#) (July 2018).

### 1. Introduction

There are two categories of pension scheme:

- **Trust-based** – often linked to a single employer, but managed by a board of trustees, who have full responsibility for the management, administration and investment of the plan. The trustee’s fiduciary duty is to act in the interests of members;
- **Contract-based** - where a pension provider, often an insurance company, runs the scheme. The scheme members will sign a contract with the provider who will make the majority of decisions about the way the scheme is run; or

In 2017, £2.2 trillion of assets were held in occupational pension schemes.<sup>1</sup> The Pension and Lifetime Savings Association (PLSA) says the UK has the largest pensions sector in the EU:



With over £1 trillion of assets under management, UK pension funds provide important capital flows to the UK economy as well as those of the EU 27. It is therefore important to British savers and their pension funds – and to the employers supporting those funds – that the UK economy gets a good Brexit.<sup>2</sup>

<sup>1</sup> HM Government, [Insurance and Pensions Sector Report](#), published December 2017

<sup>2</sup> PLSA, [Brexit and Pension Schemes: Getting the right deal for Britain’s Savers](#), January 2017

## 1.1 What is the legal framework?

The overwhelming majority of occupational pension schemes operate domestically. Of cross-border schemes operating in the UK, the majority relate to the UK-Irish border.<sup>3</sup>

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.<sup>4</sup>

The rights of pensioners of cross-border schemes to receive their pensions without discrimination is theoretically dependent on protections established in EU law. However, in practice many of the relevant matters are handled on a bilateral basis. For example, the UK has a set of arrangements for 'qualifying recognised overseas pension schemes (QROPS).<sup>5</sup>

EU legislation has an impact on them directly and indirectly:

- directly, through pensions-specific EU legislation such as the Directive on Institutions for Occupational Retirement Provision (IORP) that have been transposed into UK law; 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.<sup>6</sup>

Following the Referendum vote on 23 June 2016, the regulators said that existing law would continue to apply until the UK Government changed it. The Financial Conduct Authority (FCA) 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

### The Qualifying Recognised Overseas Pension Scheme (QROPS) regime...

A QROPS is a pension scheme established outside the UK that is broadly similar to a UK registered pension scheme.

The purpose of the QROPS regime is to "ensure that the scheme is treated as a pension scheme for regulatory and tax purposes in the country in which it is established." (HMRC Pension tax manual, [QROPS: introduction](#)).

For more detail, see Gov.UK [Overseas pension schemes](#) and Library Briefing Paper [CBP-7937](#) (June 2017)

<sup>3</sup> HM Government, [Insurance and Pensions Sector Report](#), December 2017, para 14

<sup>4</sup> 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

<sup>5</sup> HM Government, [Insurance and Pensions Sector Report](#), published December 2017, para 24-5; Gov.UK [Overseas pension schemes](#)

<sup>6</sup> Ibid

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.<sup>7</sup>

On 19 July 2016, the head of the FCA, 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.<sup>8</sup>

DWP has said that until the UK exits the EU, it will retain its rights and continue to fulfil its obligations as an EU member state. This includes the transposition of EU Directives such as IORP II, and Government is working closely with industry to ensure the impact on business is minimised. Much of IORP II is already required under the UK's regulatory framework and the UK will therefore be able to fully transpose IORP II without extensive new legislation.<sup>9</sup>

## 1.2 What does the industry want post-Brexit?

The Pension and Lifetime Savings Association (PLSA) explains that although UK workplace pension schemes tend to operate on a national basis, they 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 and administer their schemes with a minimum of cost in order to provide the best value to their members.<sup>10</sup>

In the immediate aftermath of the vote to leave, it said the ramifications were unclear: much would depend on the "precise nature of our future relationship with the EU, which may mean that some aspects of UK pension provision continue to be influenced by the EU."<sup>11</sup> Pension

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<sup>7</sup> [FCA Statement on European Union referendum result](#), 24 June 2016; [TPR warns trustees against knee-jerk reactions to market volatility](#), 14 July 2016; [Market volatility following the EU referendum: guidance statement from TPR](#)

<sup>8</sup> 'Financial watchdog calls for access to EU single market', *Financial Times*, 20 July 2016

<sup>9</sup> Source DWP

<sup>10</sup> [PLSA response to HM Treasury's review of the balances of competences: Single Market – financial services and the free movement of capital](#), January 2013; More detail about the legislation that currently applies is on the [Europe and International](#) section of the PLSA website

<sup>11</sup> [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

schemes did not want major regulatory upheaval but, whatever model the UK adopted, it was important to protect UK pension schemes from any EU legislation on a solvency-based funding regime for pension schemes that might be introduced in the longer term. This issue would come into sharp focus if the new UK-EU deal were to involve continued supervisory powers for the European Supervisory Authorities over UK-based institutions.<sup>12</sup> In January 2017, the PLSA said a successful outcome from the Brexit negotiations would include:

- *For a strong economy:* replication of both the current UK-EU framework for free trade in goods and existing EU free trade agreements with third countries. Also, a new immigration policy that continues to allow flows of talent and labour from the EU for the good of the wider economy in general and pension schemes in particular;
- *For the right regulation:* the maximum possible access to the Single Market in services – while also exempting pension schemes that operate only in the UK from damaging EU pensions regulation, such as a potential solvency-based regime for pension funds;
- *For strong financial services:* continuation of the passporting regime so that pension funds can invest efficiently.

**A bespoke model.** These features indicate that the best outcome would be a bespoke set of arrangements covering free movement of goods, services and financial services. This would protect pension schemes from a damaging EU solvency regime in the future, while preserving most of the economic benefits of an open trading relationship and maintaining ready access to global markets via the UK's financial services sector.<sup>13</sup>

The PLSA has produced a [Pension Trustee's Brexit to-do list](#). This sets out ten actions they should take, including reviewing the employer covenant and the scheme's funding position and investment strategy.

In December 2016, the ABI set out 'five key asks' for UK insurers:

- Securing a regulatory environment that is appropriate for the UK market.
- Retaining the ability to passport out of and into the UK.
- Closely mirroring the EU data protection regime to avoid a quagmire of complexity around how personal and non-personal data is protected.
- An improved future migration policy that enables the employment of high-skilled professionals from both within and outside the EU.
- A strong focus on regulatory dialogue and international agreements in overseas financial services markets, especially in India and China.<sup>14</sup>

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<sup>12</sup> PLSA, [Brexit and Pension Schemes: Getting the right deal for Britain's savers](#), January 2017

<sup>13</sup> PLSA, [Brexit and Pension Schemes: Getting the right deal for Britain's Savers](#), January 2017

<sup>14</sup> [ABI calls for 'clear commitment' to a transitional implementation period following Brexit](#), ABI, 12 December 2016

## 2. Potential areas of impact

### 2.1 Financial services across borders

There are a range of provisions across many different pieces of EU financial regulation, which allow firms in Member States to provide financial services across the EU under a common set of rules and a single authorisation from their regulator – these are often referred to as financial services passports. These arrangements allow pension schemes that access pooled funds to do so by purchasing EU-domiciled funds (Luxembourg and Ireland mostly) where the management of those funds is delegated back to the UK, and UK-based fund managers to do the day-to-day management. In addition, there are provisions that allow firms to provide services across the rest of the EU, provided that their relevant domestic regulations have been deemed equivalent to those of the EU.<sup>15</sup>

In a February 2018 speech, FCA Chief Executive Andrew Bailey explained that, when the UK leaves the EU, those relying on a passport, may be in breach of local law:

The issue arises where services provided each way in an existing contract between UK and EU counterparties may only be provided by an entity which is either authorised in the local market or passported under the Single Market rules. Thus, when the UK leaves the EU, those relying on a passport which at that point falls away, may be in breach of local law.<sup>16</sup>

He said solutions to the loss of the passporting regime ranged from the least good - leaving firms to sort it out themselves – to the best - mutually agreed and enacted solutions.<sup>17</sup>

The UK Government has committed to legislating, if necessary, for a “temporary permissions” regime to allow EEA insurance companies to continue to service insurance policies held by customers in the UK:

[...] committed to legislate, if necessary, to allow EEA insurance companies to continue to service insurance policies held by customers in the UK (through a temporary permissions regime and additional legislation if required). Once this legislation is passed, risks to UK-based customers would be mitigated. In light of this, the PRA wrote to EEA insurers on 28 March 2018 to explain that these insurers can plan on the assumption that they will only need PRA authorisation by the end of the implementation period.

EEA customers are currently reliant on their UK insurance company taking action (e.g. by transferring existing contracts to legal entities located and authorised in the EU).<sup>18</sup>

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<sup>15</sup> HM Government, [The United Kingdom's exit from and new partnership with the European Union](#), February 2017, Cm 9417, para 8.22-4

<sup>16</sup> Andrew Bailey, [The future of the city](#), 5 February 2018

<sup>17</sup> Ibid

<sup>18</sup> [Bank of England Financial Stability Report](#), June 2018, Issue No. 43; [FCA statement on EU withdrawal](#), 20 December 2017

The European Commission said insurers needed to prepare for the loss of passporting rights on withdrawal if they wanted to ensure no disruption in the current business model. Each type of contract needed to be looked at separately:

Operators in all financial services sectors need to prepare for this scenario if they wish to ensure that there is no disruption in their current business model and that they are in a position to continue serving their clients. In relation to contracts, at this juncture, there does not appear to be an issue of a general nature linked to contract continuity as in principle, even after withdrawal, the performance of existing obligations can continue. However, every type of contract needs to be looked at separately.<sup>19</sup>

In its Brexit White Paper, the Government said there was a “legitimate interest in mutual cooperation arrangements that recognise the interconnectedness of markets.”<sup>20</sup>

Guidance on financial services in the event of ‘no deal’ explains that the temporary permissions regime the Government has been working to introduce, would allow EEA firms currently passporting into the UK to continue operating in the UK for up to three years after exit, while they apply for full authorisation from UK regulators. The Government was also taking unilateral action to protect the position of EEA customers of UK firms operating in the EEA. However, fully addressing their risks required co-ordinating action with the EU:

Unless the EU acts to maintain continuity, then UK financial services firms passporting into the EEA will lose the ability to do that at the point of exit. This may have implications for their ability to meet contractual obligations with EEA-based clients, where to do so without EEA permissions would breach relevant member state rules and any applicable EU rules that apply to third countries.

The government has committed to taking unilateral action, if necessary, to resolve this issue on the UK side. However, this is not sufficient to fully address the risks, and coordinated action with the EU is necessary. An example of this is derivatives contracts between UK and EU financial firms, where permissions may be necessary from both sets of regulators to support continuity of service provision. The government is committed to working with EU partners to identify and address such risks.<sup>21</sup>

Many financial services firms who currently passport into the EEA are taking steps to ensure that they could continue to operate after exit.<sup>22</sup> The FCA had produced guidance on [Preparing your firm for Brexit](#).<sup>23</sup>

Responding to the publication of the ‘no deal’ guidance, the ABI called for urgent agreement on the issue:

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<sup>19</sup> HM Government, [The UK’s exit from, and new partnership with, the European Union White Paper](#), Cm 9417, December 2017, para 8.25-6; See also, EIOPA, [Opinion on service continuity in insurance in light of the withdrawal of the United Kingdom from the European Union](#), 21 December 2017

<sup>20</sup> HM Government, [The United Kingdom’s exit from and new partnership with the European Union](#), February 2017, Cm 9417

<sup>21</sup> HM Treasury, [Banking, insurance and other financial services if there’s no Brexit deal](#), 23 August 2018

<sup>22</sup> Ibid

<sup>23</sup> Ibid



Obviously insurers want to meet their commitments to their customers, but this problem has the potential to affect millions of insurance customers, including UK pensioners overseas. It can be fixed by co-operation between the UK and EU regulators – if the EU authorities wish to do so. Insurers have of course been making contingency plans for their own operations for many months now, but this contract issue is not one that insurers themselves can fix.<sup>24</sup>

The Political Declaration published on 14 November includes a section on financial services. It starts by recognising the interdependence of financial services across boundaries and the common interest in honest and sound markets and fair competition within them. To that end, it highlights the need for continuing close co-operation between the different regulators and regimes. The future basis of co-operation will be ‘equivalence’, which is different and less extensive than the current systems of passported services.<sup>25</sup> This is discussed in more detail in section 4.6 of Library Briefing Paper CBP 8454 [The Political Declaration on the Framework for Future EU-UK Relations](#) (November 2018).

## 2.2 Cross-border occupational pension schemes

Cross-border occupational pension schemes (i.e. schemes located in one Member State that have members working and contributing in another) are subject to particular requirements under the first European Occupational Pensions Directive (‘IORP’).<sup>26</sup> This was transposed into UK law under the [Pensions Act 2004](#) and the regulations made under it.<sup>27</sup>

There are very few cross-border schemes across the EEA – 83 in 2016. Ireland remains the home country with the most IORPs (26), followed by the UK (19).<sup>28</sup> The background to this is that before IORP, there were schemes operating across the border between the UK and Ireland under a reciprocal agreement.<sup>29</sup>

Under IORP, they need to be authorised by the national regulator – in the UK, the Pensions Regulator (TPR) – in collaboration with the regulator of the proposed destination country. TPR has produced guidance on the process for getting authorisation and approval.<sup>30</sup> EEA national regulators co-ordinate the administration of the authorisation regime via a Memorandum of Understanding known as “the Budapest Protocol.”<sup>31</sup>

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<sup>24</sup> ABI, [Urgent agreement needed on regulatory deal to address Brexit contracts issue](#), 23 August 2018

<sup>25</sup> [Outline of the political declaration setting out the framework for the future relationship between the European Union and the United Kingdom](#), November 2018

<sup>26</sup> [Directive 2003/41/EC](#)

<sup>27</sup> [Explanatory Memorandum to the Occupational Pension Schemes \(Cross-Border Activities\) Regulations 2005 \(SI 2005 No. 3381\)](#)

<sup>28</sup> EIOPA, [2017 Market development report on occupational pensions and cross-border IORPS](#), January 2018

<sup>29</sup> [Explanatory Memorandum to SI 2005/3381](#)

<sup>30</sup> The Pensions Regulator, [Cross-border schemes](#), December 2005

<sup>31</sup> CEIOPS, [Protocol Relating to the Collaboration of the Relevant Competent Authorities of the Member States of the European Union in particular in the Application of the Directive 2003/41/EC etc](#), October 2009

Under the first IORP Directive, cross-border schemes were subject to stringent funding requirements, in that they were required to be “fully funded” at all times.<sup>32</sup> This is in contrast to schemes operating within the UK which are able to put in place “recovery plans” to achieve full funding over a period of, say ten years.<sup>33</sup> IORP II effectively removes the requirement for full funding at all times: although article 14.3 still requires this, the text now continues:

if this condition is not met, the competent authority of the home Member State shall promptly intervene and require the IORP to immediately draw up appropriate measures and implement them without delay in a way that members and beneficiaries are adequately protected.<sup>34</sup>

However, there is still a risk of increased regulatory complexity for schemes operating cross-border.<sup>35</sup>

The Government has laid the draft [\*Occupational Pension Schemes Occupational and Personal Pension Schemes \(Amendment etc\) \(EU Exit\) Regulations 2018\*](#) before Parliament. This is as part of the Government’s planning to enable UK law to operate in the event that the UK leaves the EU without a withdrawal agreement in place. It includes provision for cross-border schemes to continue to operate across borders post-Brexit. The Explanatory Memorandum states:

7.5 The cross-border authorisation regime requires reciprocal arrangements for the sharing of information between the pensions regulators of EEA Member States relevant to the cross-border activities of an authorised occupational pension scheme. On exit from the EU and the EEA, the UK’s occupational pension schemes will no longer meet the criteria to obtain authorisation for cross-border activity and the reciprocal arrangements for sharing information between national regulators will fall away.

7.6 UK private occupational pension schemes accepting contributions from other countries will still be subject to section 66A (3) of the *Pensions Act 1995* (and corresponding Northern Ireland legislation), which provides that schemes must treat non-UK members in the same way as members who work wholly in the UK in relation to contribution and membership entitlements.

7.7 These regulations therefore remove the requirement for occupational pension schemes to obtain authorisation from the Pensions Regulator for cross-border activities from the *Pensions Act 2004* and consequential regulations (and corresponding Northern Ireland legislation).<sup>36</sup>

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<sup>32</sup> [EU Occupational Pensions Directive 2003/41; Occupational Pension Schemes \(Cross-border activities\) regulations 2005 \(SI 2005 No. 3381\)](#),

<sup>33</sup> For more detail, see Library Note SN 4877 [Pension scheme funding requirements](#) (March 2013)

<sup>34</sup> PLSA, [Brexit and Pension Schemes, Getting the right deal for Britain’s savers](#), January 2017; [PLSA website/Europe/IORP Directive; Directive EU 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision \(IORPS\)](#) – pre-amble, para 18

<sup>35</sup> PLSA, [Brexit and Pension Schemes, Getting the right deal for Britain’s savers](#), January 2017

<sup>36</sup> [Explanatory Memorandum](#)

The Pensions Regulator will provide guidance to the small number of UK pension schemes which are currently authorised for 'cross-border activity' within the EU.<sup>37</sup>

## 2.3 Payment issues

The Pensions Advisory Service explain that although practice varies, pension scheme and annuity providers do not typically pay pension benefits directly into an overseas bank account, leaving the individual to transfer the money from a UK bank account – which may mean there are transfer fees and exchange rate variations on the money they receive. When and how any benefits are exchanged may make a big difference to how much an individual gets.<sup>38</sup>

For DB schemes where the pension is paid directly by the scheme it is usually a case-by-case decision for the trustees as to whether they will agree to pay a member's pension into an overseas bank account. This applies regardless of whether the member has moved to an EU/EEA or third country. There are administration costs for the scheme so it is typically only the larger schemes that will consider it, and such decisions are primarily dependent on the ease with which their scheme systems can connect with those of the bank in the particular country the member has moved to. Trustees frequently insist on paying the pension into a UK bank account and leaving the member to arrange moving the money abroad. This passes currency costs from the scheme to the recipient and there may be less onerous regulatory requirements, such as a lower level of due diligence under the anti-money laundering regime, by not paying the money abroad.

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<sup>37</sup> Ibid, para 11.1

<sup>38</sup> <https://www.pensionsadvisoryservice.org.uk/about-pensions/when-things-change/moving-abroad>.

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