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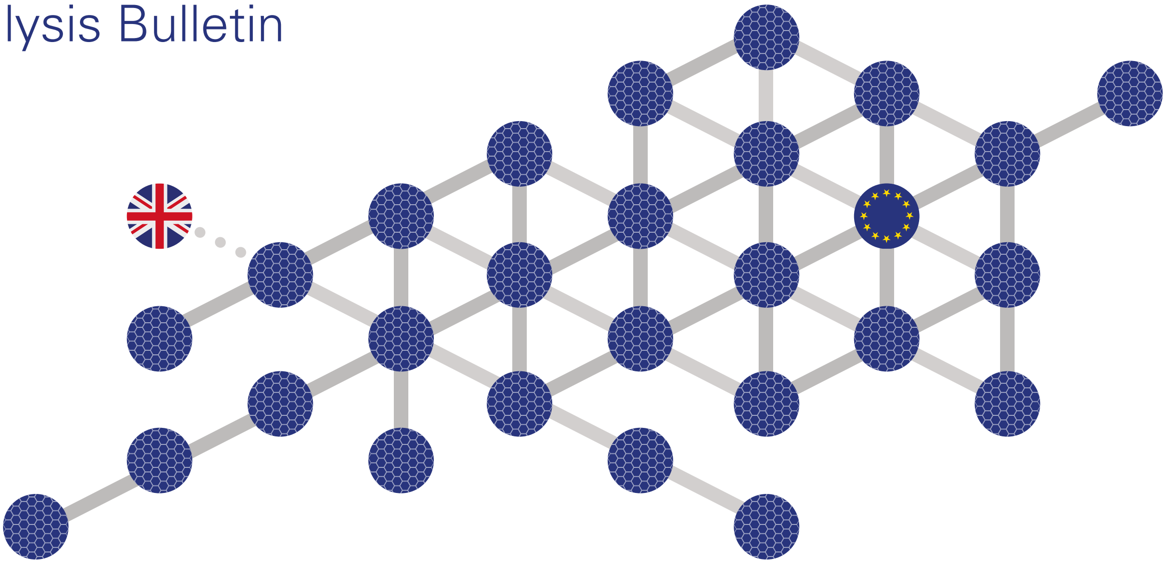
Brexit Analysis Bulletin
Pensions



The United Kingdom has chosen to leave the European Union (EU). Before the referendum, we considered in detail the potential impact of Brexit on the UK pensions landscape, highlighting a number of areas of uncertainty for employers, trustees and insurers. These areas remain no less clear following the referendum, as intense debate surrounds the timing and nature of any exit deal and markets continue to experience significant volatility. However, the key message is that there has been no immediate change to the legal status of the UK and the EU as a result of the referendum, and that the many provisions of EU law that affect UK pension schemes will continue, for now, to apply. In this update, we provide an overview of how the decision by the UK to leave the EU may impact the pensions field.

The UK pension system

The UK has a well-developed occupational and private pension system which has evolved over many years. The UK's state pension provision was established long before the UK became a member of the EU. UK occupational pension fund structures are traditionally derived from the UK trust law foundations, a key point of difference from many other EU states. The UK tax system is also unique and critical to the foundations of our pension system.

Notwithstanding the distinctive characteristics of the UK's pension system, the EU has an unquestionable influence, particularly in the areas of pension protection, equality, including sex and age, mobility of labour, employment protection and data protection. These European requirements have subsequently been incorporated into UK law by implementing legislation and by adapting practice to be compliant with case law emanating from the Court of Justice of the European Union (CJEU).

The decision by the UK to leave has not had an immediate effect on pensions. However, going forward, the status of future EU requirements affecting pensions will depend on the specific deal struck with the EU following the UK's decision to withdraw. If the UK is obliged to comply with EU requirements without influence there could be issues for scheme operation and funding.

Occupational pension schemes – sponsor covenant, investments and funding

Depending on the commercial impact of the terms of Brexit, the financial covenant of sponsors underwriting occupational final salary pension schemes may be affected. Trustees of such schemes, as part of their duties, are required to regularly review the strength of the employer covenant supporting their scheme. This involves an analysis by covenant advisers of a range of matters including the sponsor's detailed financial position and the industry in which a scheme employer operates. It is possible that the decision to leave the EU could negatively impact trade links between the UK and Europe which could in turn weaken the employer covenant, whether the scheme sponsor itself or a guarantor connected with the scheme. However, it is impossible to determine the state of trading terms until negotiations between the UK and EU have concluded.

Financial markets have experienced significant volatility following the UK's decision to leave the EU. However, the long-term effects on scheme investments and funding remain unclear, and Trustees should engage fully with investment advisers and sponsoring employers to protect the security of member benefits.

Equalisation and equality

The UK had developed equality legislation in the 1970s but the area of pensions had not been specifically captured. The principles of non-discrimination and equal treatment in occupational pensions have their roots in the EU, having been subsequently incorporated into UK law and are currently set out in the Equality Act 2010.

Discriminating between men and women in terms of their entitlement to access benefits under occupational pension schemes was established in the Barber case by the CJEU in 1990. The court ruled that pensions are 'pay' under European treaties, and that both men and women must enjoy equal retirement ages in gaining access to their pension. This and subsequent court decisions which clarified the decision in Barber have required UK pension schemes to 'equalise' the retirement ages of their male and female members since that time.

Similarly, age related discrimination had an impact on occupational pension schemes. The UK enacted the Employment Equality (Age) Regulations 2006 in order to comply with overarching European requirements designed to guard against age related discrimination. Pension schemes are by nature designed to have key age related trigger points. Therefore there have been certain exceptions built into the 2006 Regulations in order to enable occupational pension schemes to function. Employers and trustees must not discriminate against members in ways that are not otherwise exempt or legally justified e.g. minimum age requirements for drawing upon scheme benefits and closure of schemes to new entrants.

While the leave vote has not caused any immediate change to the UK's current position regarding equalisation or age related discrimination, it may lead to a divergence between UK and EU law on these points over time depending on the UK's exit and future engagement terms. The UK Parliament and courts may no longer be within the jurisdiction of the CJEU. Further UK statutes could be interpreted by the courts on a purely 'UK' basis, rather than by reference to European treaties, regulations or case law. Existing EU requirements have already been brought into UK legislation and practice and will continue to have effect until the details of the UKs new relationship with the EU are settled.

Transfer of Undertakings (Protection of Employment) Regulations (TUPE)

The concept of protecting the pension rights of employees on the sale of a business was originally set out at European level, within the Acquired Rights Directive 1977 (ARD). Historically, pension entitlement had not been included in the ARD, nor in implementing TUPE regulations. However the situation changed following various decisions of the CJEU and the enactment of related pensions legislation in the UK.

Under current TUPE legislation and in light of various decisions of the CJEU, the treatment of pensions in a business sale is complex. The pension benefits that employees can expect in their new employment will be highly dependent on whether their rights are personal pension rights, which do transfer with the employee as part of a TUPE transfer, or occupational pension scheme rights. The latter do not directly transfer, but give rise to a particular contribution rate from the new employer and additional potential transferred pension related rights dealt with under case law.

Following the decision by the UK to leave the EU there has been no immediate change to the UK's position on pension entitlements post business sales. Any future deal would depend on the UK's future arrangements and political will with a suitable alternative.

European Insurance and Occupational Pensions Authority (EIOPA)

The European Insurance and Occupational Pensions Authority (EIOPA) is a key contributor to the establishment of common regulatory and supervisory standards and practices in the EU. Its role is widely known through the solvency requirements. As an EU member state, the UK has an influence on the outcomes from EIOPA. Once the UK has left the EU, depending on the terms of any deal reached, the UK may find itself bound to continue to apply EU requirements while having no ability to influence decision-making as a member of EIOPA.

The Pension Protection Fund and compensation levels

The UK's pension lifeboat in case of employer insolvency, the Pension Protection Fund (PPF), was established under UK law and intended to implement the EU Insolvency Directive.

There is a growing concern that the CJEU may deem the current levels of compensation as being inadequate to comply with European law, which could result in employers being subject to an increased financial burden via increased levies. However, following the decision to pursue Brexit, there is a possibility that the UK will not be obliged to observe any increased compensation requirements required under European law.

Cross border scheme funding arrangements

Pension schemes need to comply with stringent funding requirements with schemes operating cross-border within the European trading block, having to be 'fully funded' at all times. As a result cross-border schemes remain relatively rare with the funding requirements having been seen as a block to pan-European pension arrangements. As a result any direct impact on this from a Brexit is unlikely to be significant.

Concluding remarks

Companies and trustees operating occupational pension schemes should keep Brexit on their agenda and risk register. With immediate concerns on funding, investments and covenant, trustees should consider whether their existing protocols for dealing with those concerns are sufficient or need to be strengthened following the outcome of the referendum.

SHEPHERD AND WEDDERBURN'S BREXIT ADVISERS

JOINING THE DOTS OF THE EU REFERENDUM

What next?

Shepherd and Wedderburn has been for many years offering balanced and impartial advice on how the different scenarios might play out in the event of constitutional change.

Now that the vote has been cast to leave the EU, members of our dedicated Brexit group continue to interrogate the regulatory and commercial issues and to advise clients on next steps and outcomes.

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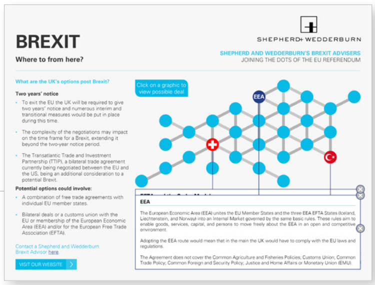
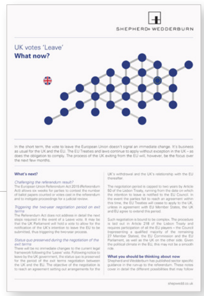
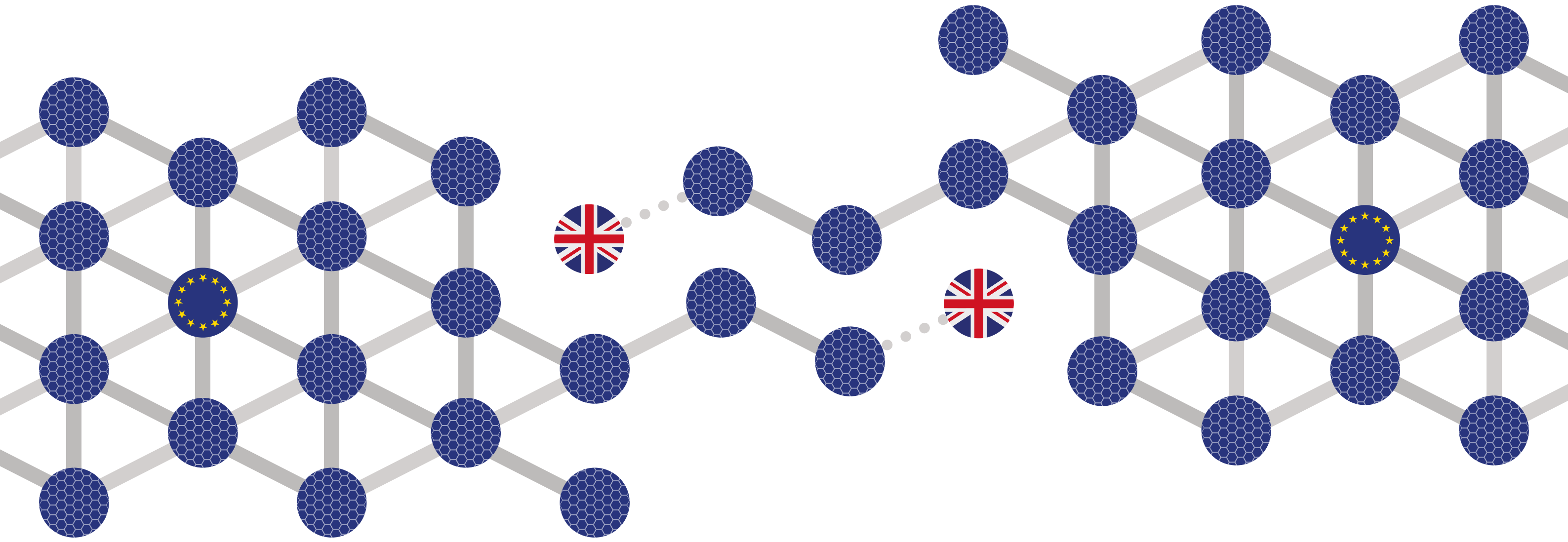


Click here to read our 'What now' Brexit bulletin.





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