



## BRIEFING PAPER

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# Brexit - implication for private pensions

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### Summary

The implications of the vote to leave the EU on 23 June are as yet unknown. This note looks at the emerging discussion about the potential impact on private pensions (i.e. occupational and personal pensions). Other issues are covered on the [Brexit: next steps of UK's withdrawal from the EU](#) section of the Parliament website. See, in particular CBP-7894 [Brexit and State Pensions](#) (March 2017) and CBP-07628 [Brexit and financial services](#) (March 2017).

## 1. What is 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.<sup>1</sup>

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

<sup>1</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

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

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.<sup>3</sup>

The website of Pensions Europe (which describes itself as the leading voice of workplace pensions in Europe)<sup>4</sup> has information about current [key issues](#) on its website.

## 2. What will Brexit mean for this?

Following the 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 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>5</sup>

On 19 July 2016, 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.<sup>6</sup>

The PLSA says pension schemes do not want major changes:

UK pensions law is extensively intertwined with EU law, regulation and court rulings. There is no need to dismantle this framework – and very little to gain from doing so. In fact, the overwhelming message from PLSA members is that they do not want major regulatory upheaval.<sup>7</sup>

They would welcome clarification on whether the [IORP II Directive](#) will be implemented in the UK:

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<sup>2</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>3</sup> Ibid

<sup>4</sup> [Pensions Europe/About us/full members](#)

<sup>5</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>6</sup> 'Financial watchdog calls for access to EU single market', *Financial Times*, 20 July 2016

<sup>7</sup> PLSA, [Brexit and Pension Schemes: Getting the right deal for Britain's savers](#), January 2017

A revised version of the IORP Directive, 'IORP II', has recently been approved by the European Parliament and ECOFIN and will reach the EU's statute books in early 2017. The implementation date – when Member States will be required to have IORP II in place - will fall on 12 January 2019.

The final text of 'IORP II' is much less complex and prescriptive than the EC's original proposal and is largely acceptable to UK pension schemes, although there would be some unwelcome extra compliance burdens.

It is difficult to see much benefit for UK pension schemes from implementation of IORP II perhaps just weeks before the UK leaves the EU, but this is not the most crucial issue for pension schemes. Schemes would welcome clarification from the Government on whether they will have to implement IORP II and, if so, what this will mean in practice in the UK.<sup>8</sup>

However, the PLSA says that of greater concern is potential EU legislation on a solvency-based funding regime for pension schemes:

The EU's own insurance and pensions authority, EIOPA, which supports the solvency agenda, has estimated that the Holistic Balance Sheet would increase the funding requirement for UK schemes by €650 billion.

The UK has been successful in blocking these proposals in their various guises over recent years, acting in partnership with Germany, the Netherlands, Ireland and Belgium. With the UK out of the EU, the risk of solvency being brought forward again would increase. The worst case scenario for UK pension schemes would be to find themselves more vulnerable outside the EU to the damaging regulation that was successfully blocked when the UK was inside the EU.

Whatever model the UK adopts for its future relationship with the EU, it is important that it should protect pension schemes that operate only in the UK (the overwhelming majority) from any potential pension solvency system 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. Some press comment has speculated that the EBA and ESMA could retain powers over UK-based banks and financial institutions as part of an agreement on 'equivalence' and 'passporting'. The PLSA would be concerned if this were to involve no change in EIOPA's role and continued exposure to potential EU solvency rules; hence the PLSA's view that UK-only pension schemes should be exempt from any such solvency regulation.<sup>9</sup>

There have been questions in the pensions press about whether the Government would proceed with complex rules to require equalisation of Guaranteed Minimum Pensions (GMPs).<sup>10</sup> The PLSA argues that it is "unlikely that the UK's own *Equality Act 2010* and continuing participation in the European Convention on Human Rights will prevent this outcome."<sup>11</sup>

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.

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<sup>8</sup> Ibid

<sup>9</sup> Ibid

<sup>10</sup> 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; See also [Brexit: the impact on pension schemes for employers and trustees, 27 September 2016](#)

<sup>11</sup> PLSA, [Brexit and Pension Schemes: Getting the right deal for Britain's savers](#), January 2017

### 3. What about market changes?

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.”<sup>12</sup>

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.

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).<sup>13</sup>

It said trustees should consider the extent to which volatility and changing market conditions affected the longer-term view of expected risk and returns. Trustees of defined contribution schemes might want to make changes to default arrangements as the implications became clearer. Good member communications would remain vital to “help members engage and make decisions that lead to good outcomes in retirement.”<sup>14</sup>

The PLSA says that the most obvious immediate policy consequence of the referendum had been:

[...] the Bank of England’s announcement of a 0.25% reduction in the base rate and further £60 bn of quantitative easing (QE) announced on 4 August. QE, in particular, has undoubtedly contributed to pension fund deficits.<sup>15</sup>

Lane Clark and Peacock’s [September 2016 de-risking update](#) said the Brexit vote had reduced the affordability of full buy-out (where the scheme pays an insurer to take on its liabilities) for many schemes but opened up opportunities for some able to move quickly:

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<sup>12</sup> [ABI comments on EU Referendum vote](#), 24 June 2016

<sup>13</sup> [Market volatility following the EU referendum: guidance statement from TPR, July 2016](#)

<sup>14</sup> Ibid

<sup>15</sup> PLSA, [Brexit and Pension Schemes: Getting the right deal for Britain’s savers](#), January 2017

### Challenges for full buy-outs

Full buy-outs have been limited to smaller schemes so far in 2016 as insurers got to grips with how the new capital rules impact deferred pensioner pricing. Schemes have also had to battle with falling yields in the wake of the EU referendum vote. Whilst the fallout from the vote opened up attractive pensioner buy-in pricing opportunities for schemes that could move quickly (see ICI Brexit-driven opportunity below) it has reduced affordability for full buy-out for all but the best hedged schemes.

### ICI Fund seizes Brexit-driven opportunity

The EU referendum vote opened up opportunities for schemes that could move quickly. In particular, insurers were able to put forward improved buy-in pricing as credit spreads spiked in the wake of the vote, allowing insurers to purchase investments at lower cost and pass this saving onto the scheme in their pricing. We helped the ICI Fund seize this opportunity completing a £750m buy-in with L&G transacted in record time for a transaction of this scale – just eight working days after the vote. We estimate that moving quickly saved £10m on the price, bringing it within the Trustee’s target metrics.<sup>16</sup>

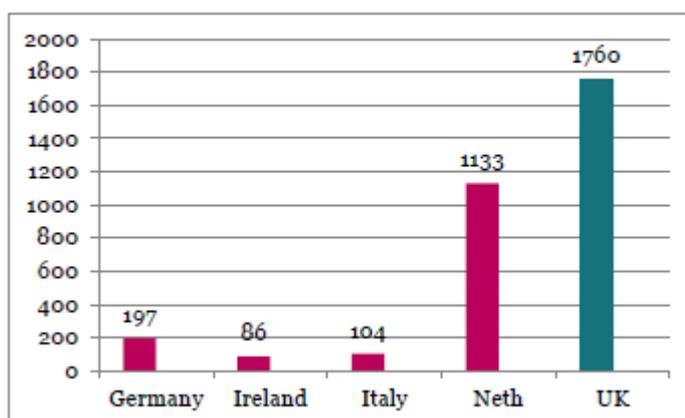
## 4. What does the pensions industry want?

According to the Pension and Lifetime Savings Association (PLSA), the UK has the largest pensions sector in the EU:

The PLSA’s members provide pension for 20 million people – people working and saving towards their retirement and pensioners already receiving their benefits. They have a direct interest in pension schemes remaining strong. The key Brexit risk for them stems from a potential reduction in economic growth.

Auto-enrolment has brought 7 million more people into pension saving – a great British success story that many other EU Member States are looking to emulate.

**EU Member States with over €50 billion of workplace pensions assets<sup>1</sup>**



### MAJOR INVESTORS

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>17</sup>

<sup>16</sup> EU regulation and Brexit vote impact de-risking in 2016, *Occupational Pensions*, November 2016; [Lane Clark and Peacock, Pension de-risking September 2016 update](#)

<sup>17</sup> PLSA, [Brexit and Pension Schemes: Getting the right deal for Britain’s Savers](#), January 2017

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It says pensions are concentrated in strategic sectors (especially financial services, manufacturing and the wider services sector) and that Brexit “particularly needs to work for pension schemes in these sectors as well as for the companies that sponsor them.”<sup>18</sup>

In the immediate aftermath of the vote to leave, it said the ramifications were unclear:

Much will 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. In other areas, UK pension law may need to be disentangled from EU legislation.<sup>19</sup>

More recently, it has said that:

From the pension scheme perspective, a successful outcome from the Brexit negotiations would include the following:

- *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>20</sup>

More detail is in PLSA position paper, [Brexit and pension schemes: getting the right deal for Britain’s savers](#) and a two page summary, [Brexit and pension schemes: getting the right deal for Britain Savers](#) (January 2017).

The ABI has called on the Government to “make a clear commitment that it will seek an early agreement with our European partners on a high level transitional implementation period which will help avoid economic shocks to both the UK and the EU”. It has also 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>21</sup>

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<sup>18</sup> bid

<sup>19</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

<sup>20</sup> PLSA, [Brexit and Pension Schemes: Getting the right deal for Britain’s Savers](#), January 2017

<sup>21</sup> [ABI calls for ‘clear commitment’ to a transitional implementation period following Brexit](#), ABI, 12 December 2016