



# BREXIT: PENSION SCHEME PREPAREDNESS

Beyond Brexit – Part of the Horizon Scanning series

This update considers actions pension schemes should be taking in preparation for 1 January 2021. At the end of the update is a short checklist of actions for pension scheme trustees.

## A. All pension schemes

### 1. Overall impact

*With the 30 June 2020 deadline for extending the implementation period having now passed, and with little sign of substantive progress in the negotiations on the future of the UK-EU relationship, pension scheme trustees must once again consider preparing for the possibility of a no-deal or “minimal deal” scenario following the end of the implementation period at 11:00pm on 31 December 2020.*

The end of the implementation period does not represent a “cliff edge” for pension schemes in terms of dramatic changes in law. Broadly, the European Union (Withdrawal) Act 2018<sup>1</sup> will convert into UK law existing EU legislation which has direct effect in the UK at the end of the implementation period. It preserves existing UK laws which implement EU obligations, on the basis that much of EU law is enshrined into UK law. After the end of the implementation period there will be limited circumstances in which the Court of Justice of the European Union (“CJEU”) has jurisdiction and the UK courts will to some extent be bound by past decisions.<sup>2</sup>

Further, it also seems unlikely that the UK government would look to repeal significant protections for members now enshrined in UK law, such as the more recent requirements arising from the IORP Directive<sup>3</sup>, although there will be flexibility to allow amendments in future. This is supported by a statement from the Pensions Regulator in January 2019 that it did not expect the UK’s departure from the EU, “to have a significant effect in respect of the legislative basis under which schemes operate”.

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<sup>1</sup> As amended by the European Union (Withdrawal Agreement) Act 2020.

<sup>2</sup> See Section 6(1) and 6(2) of the European Union (Withdrawal) Act 2018. For example, under section 6(2), a UK court or tribunal may have regard to anything done after the end of the transition period by the CJEU, another EU entity or the EU so far as it is relevant to any matter before the court or tribunal.

<sup>3</sup> 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

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Having said that, there are a number of points that trustees will want to consider in the build up to 1 January 2021, many of which are wider than pure legal considerations.

### 2. Payment of benefits for UK nationals in the European Economic Area (EEA)<sup>4</sup>

*Department for Work and Pensions (DWP) [guidance](#) (updated on 19 October) makes clear that the government does not expect the payment of pensions from a pension scheme to overseas members to change in 2021 whatever the outcome of negotiations (although media reports suggest that UK banks may no longer be willing to operate UK bank accounts for EEA residents). However, the position on the purchase of annuities to pay pension benefits is already causing an issue in practice.*

Trustees typically insist on paying a pension into a UK bank account where a member lives overseas, although some schemes do permit payment to an overseas bank account. There have been reports in the media that some UK based banks are to close the UK bank accounts of EEA residents, and to cease to offer overseas accounts, following the end of the implementation period. Trustees will want to check with scheme administrators that nothing interrupts the payment of benefits to members living overseas in the EEA.

The DWP guidance flags that if the pension is being paid into a UK bank account, the bank should contact the member if they need to change the way pension is received. The scheme administrators may therefore need to direct any member queries about this to the relevant bank.

In contrast, the purchase of annuities in order to pay pensions for members residing in EU countries is already something that has become an issue in practice. Currently, under the system of “passporting” an authorised UK insurer is able to conduct insurance business throughout the EEA. In the absence of further negotiated agreement on this point, this will end on 31 December 2020. As is explained in detail in the [recommendations](#) from the European Insurance and Occupational Pensions Authority (EIOPA), insurance companies wishing to conduct business with EU residents post-Brexit may need to apply for permission from each member state they want to operate within.

The FCA has pointed out in its [guidelines](#) that whether regulatory permissions in a local EEA jurisdiction are needed will depend on local law and the approach of the local authorities in that jurisdiction. Many insurers without an authorised branch in the relevant local EEA jurisdiction are unlikely to want to risk writing new business outside the UK.

The FCA notes that EIOPA helpfully recommends that life insurance contracts between UK firms and UK-based customers who subsequently move to the EEA should not be regarded as cross-border business.

There is also a technical issue that may arise from the purchase of annuities in the EEA as regards the statutory discharge that is available on the purchase of an annuity. This may mean it will be less attractive for trustees to purchase overseas annuities.

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<sup>4</sup> The EEA covers EU member states and Iceland, Liechtenstein, and Norway. The guidance referred to here also applies to UK nationals who live in Switzerland.

### 3. Transfers of benefits for UK nationals in the European Economic Area (EEA)<sup>5</sup>

*There is likely to be limited impact on transfers of benefits to pension schemes based in the EEA.*

Pension schemes can currently make a “recognised transfer” for tax purposes to a Qualifying Recognised Overseas Pension Schemes (or “QROPS”). One of the exclusions for the tax charge of 25% of the transfer value, which applies on such a transfer, is where the QROPS is established in an EEA state and the individual is resident in the EEA for 5 full tax years after the transfer. This exclusion will be amended so that the exclusion will still apply where the QROPS is in the EEA and the individual is resident in either the UK or the EEA after the transfer.

The position in relation to transfers to QROPS established in Gibraltar has created some uncertainty given its unique status. Gibraltar was treated as an EEA state by virtue of the Treaty on the Functioning of the EU and transfers to an EEA state are not currently subject to the charge. In Pension Schemes Newsletter 119, HMRC has confirmed that transfers to Gibraltar will be treated as they were before the UK left the EU i.e. not subject to a tax charge during the implementation period. HMRC has said that as soon as the position after the implementation period becomes clear, the Pensions Tax Manual will be updated accordingly.

### 4. Data Protection

*The position here will depend on what is agreed before the end of the implementation period.*

The previous government said it would permit personal data to flow freely from the UK to the EEA, but the EU did not make a similar commitment. It is understood that negotiations are being held on an “adequacy” decision to permit this.

If the data privacy laws in the UK are considered “adequate” by the EU, this would allow the flow of personal data to continue to and from the UK. However, if this is not the case, pension schemes will need to consider what other mechanism they can use for the flow of data.

In this context, a recent decision of the Court of Justice of the European Union<sup>6</sup> has muddied the waters. While the court did support the use of standard contractual clauses governing the transfer of data outside the EEA, it suggested that data controllers would need to take further steps to check whether the data security measures were adequate. Standard contractual clauses might currently used by trustees for the transfer of personal data outside the EEA. If no EU “adequacy” decision is forthcoming, the use of standard contractual clauses may not provide a straightforward solution. The decision may also have wider implication for other mechanisms for the transfer of personal data, such as the use of binding corporate rules governing the transfer of data amongst different group entities.

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<sup>5</sup> The EEA covers EU member states and Iceland, Liechtenstein, and Norway.

<sup>6</sup> In Data Protection Commissioner v Facebook Ireland and Maximillian Schrems (Case C-311/18) EU:C:2020:559.

### 5. Cross-border schemes

*Whilst there are a limited number of cross-border schemes in place, there will be significant changes after 31 December 2020.*

The cross-border pensions regime, under which UK schemes can be authorised to operate across EU member states, will be repealed at the end of the implementation period.

Schemes currently within the regime (usually UK schemes that have Republic of Ireland members) will be treated as third country undertakings and will have to comply with the rules of each Member State in which they operate. The Pensions Regulator's [guidance](#), updated in March 2020, gives details. Affected trustees should check this guidance periodically for updates, and should also check the position with the relevant authority in the host member state in which their scheme operates.

## B. Defined benefit pension schemes only

### 1. Covenant, investment and funding issues

*The Pensions Regulator has issued guidance, ["Prepare your DB scheme for a future EU relationship"](#).*

Brexit will have an impact on many sponsors that needs to be considered independently from COVID-19. Concerns about employer covenant are likely to have been more acute for some sponsors (although other sponsors may have not been so adversely affected) as a result of the pandemic, and the Regulator has issued a number of pieces of guidance, including as to the possibility of deferral of deficit repair contributions. The statements in the Brexit guidance cover similar themes, such as the need to consider whether a covenant review is required to assess whether there are structural changes to the sponsor, and the need to ensure the pension scheme is treated fairly as compared to other stakeholders.

On investments, the messages in the Brexit guidance are consistent with the Regulator's desire for schemes to focus on a long term funding target, as outlined in its 2020 Funding Statement, in the Pension Schemes Bill currently making its way through Parliament, and consultation on its approach to revising the Funding Code published for consultation in March 2020 (with a draft Code to appear later this year/next year for consultation). Pension schemes should not be swayed by short term movements in markets.

### 2. EMIR<sup>7</sup>

*No immediate action is required in relation to derivatives transactions cleared in the UK but there is, as yet, no clarity on what happens to contracts to which UK pension schemes are a party that are cleared in the EU.*

EMIR requires certain classes of over-the-counter (or "OTC") derivatives contracts to be cleared through a central counterparty. Broadly, EMIR requires affected pension schemes to clear and report trades, and to put in place mitigation techniques for uncleared trades. Many pension schemes commonly use OTC derivatives to hedge against inflation and interest rate risk. Although the requirement has a significant impact on a large number of counterparties

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<sup>7</sup> EU Regulation on OTC derivatives, central counterparties and trade repositories (648/2012)

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that engage in derivatives trading, pension schemes currently benefit from a temporary exemption.

For derivatives transactions cleared in the UK after the end of the implementation period, no action is required, because the UK government has confirmed that the EU EMIR pensions exemption from the central clearing requirement, (in place until at least 18 June 2021) will be introduced into UK law.<sup>8</sup> It has said that the temporary EU exemption for pension scheme arrangements contained in the EMIR “Refit Regulation” will be on-shored and continue to apply to both UK and EEA pension scheme arrangements.

But the position for UK pension schemes clearing derivatives transactions in the EU is less clear. ISDA has asked the European Commission and the European Securities and Markets Authority (ESMA) to take action to ensure that, post-31 December 2020, the pension fund clearing exemption continues to be available to EU counterparties which enter into new OTC derivatives with UK pension arrangements but the issue has yet to be resolved.

In any event, as part of investment planning for Brexit, trustees may need to consider whether their current level of interest rate and inflation hedging remains appropriate. Further, trustees may need to consider the potential need to cover cash margin calls on derivative hedging positions.

### 3. Overseas guarantees

*There may be an impact for those pension scheme trustees with an overseas guarantee from an entity based in the EEA.*

Currently, there is a smoother process for enforcement of a judgment against an EEA-based guarantor, in a situation where the guarantee needs to be called on. However, from 1 January 2021, absent agreement with the EU, enforcement will be subject to national rules and so could potentially be more difficult to achieve for trustees. This is something the trustees should monitor as it may impact the extent to which trustees can place reliance on the guarantee.

On a related note, if the sponsor of the scheme has an overseas parent, the potential weakening of sterling may make cash investment in the currency of the parent cheaper. This means a cash contribution to the scheme may be more affordable.

## C. Defined contribution pension schemes only

### 1. Communications and investments

*The [guidance](#) from the Pensions Regulator for DC schemes focuses on investments, member communications and operations and administrations.*

The key messages highlight the importance of careful communications with members, especially those members who are approaching retirement who may be nervous about the impact on savings. Trustees will also want to monitor the scheme’s default fund to consider its possible exposure to Brexit-related investment risks.

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<sup>8</sup> In February 2019, HM Treasury published guidance on EMIR pension scheme arrangements in a no-deal Brexit scenario.



## BREXIT CHECKLIST FOR PENSION SCHEMES

All Pension Schemes	
1.	Check with scheme administrators that nothing will interrupt the payment of benefits to members living overseas in an EEA country.
2.	Check with scheme administrators what is being done about purchasing annuities for members residing in an EEA country.
3.	Check with scheme administrators what is being done about the transfer of any personal data outside the UK.
4.	Check with the sponsor what is being done about the transfer of any personal data outside the UK.
Cross-Border Schemes	
1.	Confirm what action is being taken at the end of the implementation period.
DB Pension Schemes	
1.	Consider the Pension Regulator's guidance, " <a href="#">Prepare your DB scheme for a future EU relationship</a> ", including as to investment, employer covenant, operations and administration and member communications.
2.	Consider the impact on any sponsor guarantee based in an EEA country.
DC Pension Schemes	
1.	Consider the Pension Regulator's guidance, " <a href="#">Prepare your DC scheme for a future EU relationship</a> ", including as to investments, member communications and operations and administrations.