

Leaving the European Union: The impact on occupational pension schemes

Friday 24 June 2016

The UK has voted in favour of leaving the European Union.

For companies and trustees who run occupational pension schemes, this raises the question of how the UK's departure from the EU would affect their legal obligations.

To consider this, we need to separate the periods before and after leaving the EU.

Position while in the EU

The Lisbon Treaty enables a country which has decided to leave the EU to serve a withdrawal notice on the European Council.

A country which does this remains a full member state until the conclusion of what is widely described as a two-year withdrawal process (although the actual timescale is impossible to predict). The leaving country has the intervening period in which to agree the terms of its withdrawal with the other member states.

The withdrawing country has all the rights and duties of a full member state until the end of the withdrawal process. This includes the impact not only of existing EU laws, but also of new ones (whether in the form of directives, regulations, or decisions of the European Court) arising during the period between the withdrawal notice and the date of exit.

Position after leaving the EU

The main principle is that a country is not subject to EU law if it is outside the EU.

However, the reality following a UK departure may prove to be less straightforward:

- A great deal of EU law has been written into UK legislation. This will survive as UK law, unless and until it is repealed or amended by the UK Parliament.
- The impact of this UK legislation may continue to be shaped by past and future decisions of the European Court of Justice (the "ECJ") for years to come:
 - *Past ECJ decisions*: Until now, the UK courts have deferred to the ECJ when interpreting this UK legislation. Whether UK judges could "re-interpret" UK law after the link to EU law is broken remains to be seen – but we would not expect them to do so lightly.
 - *Future ECJ decisions*: Future ECJ decisions too may have some influence. UK judges, even if they find themselves no longer bound to follow the ECJ's interpretations of EU law, may be wary of adopting a contrary line without a compelling reason.

- Some requirements of EU law are directly enforceable in the member states, and so apply in the UK without having been written into UK law. These requirements would simply fall away on leaving the EU. However, the UK Government might want some or all of these still to apply (at least initially, if only for the sake of continuity). This could be achieved by:
 - enacting UK legislation to write these requirements into UK law; or
 - providing in the withdrawal agreement for these requirements to continue to apply directly to the UK, as part of the UK's negotiated continuing future relationship with the EU.
- If the UK were to remain in the single market, then this would be likely to involve the UK remaining subject to much of the EU law that would have applied to it as a continuing EU member state.

Pensions issues

The following pages look at EU law requirements of specific relevance to occupational pension schemes, dividing them into those which have been written into UK law (and so will continue to apply for as long as they remain in force) and those which have not.

The economic and political implications of leaving the EU may well eclipse the regulatory consequences that we have outlined here.

The financial impact for companies and on investment conditions may raise issues for trustees when carrying out their ongoing funding and investment roles. The particular circumstances will inevitably vary from scheme to scheme, as will the steps that trustees can or ought to take. Your usual Linklaters pensions contact will be happy to advise further.

UK legislation enacted to implement EU law

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EU issues not written into UK legislation

These would fall away upon the UK leaving the EU, subject any specific arrangements entered into to the contrary.

Equality and protection from discrimination

The Equality Act 2010 implements the EU law protections against discrimination on grounds of such matters as sex, age and sexual orientation. These protections extend to pension rights.

The protections relating to sex and sexual orientation are now generally regarded as uncontroversial, and there is no expectation that Parliament would seek to repeal them in the foreseeable future.

The age discrimination protections are less straightforward. These are still considered by many to be anomalous in the context of pension schemes (even with the statutory exceptions that are available), and they can give rise to difficulties. Conceivably, once out of the EU, a future Parliament might try to soften their impact; however, most schemes have learnt to live with these protections and a UK Government is unlikely to see this as a priority.

There are areas where the ECJ could at a future date rule that UK legislation does not go as far as EU law requires. Examples of this are:

- whether schemes must take into account the different guaranteed minimum pensions payable to men and women, in determining whether they meet the “equal pay for equal work” requirement;
- whether transfer values must be based on unisex actuarial factors; and
- whether same-sex survivors’ pensions must be based on the whole of the deceased’s service (and not just service from 5 December 2005 – or 6 April 1988 for contracted-out benefits – as UK law currently permits).

Each of these would give rise to potential cost implications for schemes (although some more than others).

Employment protection on business transfers

The Transfer of Undertakings (Protection of Employment) Regulations 2006 (“**TUPE**”) implement the EU *Acquired Rights Directive*.

TUPE mainly applies when there is a business transfer. Its effect is to transfer workers’ employment contracts from one employer to another.

However, the rights transferred do not include old age, invalidity and survivors’ benefits under occupational pension schemes. This wording can give rise to problems – especially when it means that certain pension rights under a scheme do transfer, but others do not.

Leaving the EU would allow Parliament to rationalise these protections, but any significant weakening of them could be seen as controversial.

This is another area where future ECJ decisions could add to the obligations that TUPE is currently thought to impose.

An example of where this has already happened was in the *Beckmann* case. In *Beckmann*, the UK court referred the question of whether certain early retirement payments were “old age” benefits, under the *Acquired Rights Directive*, to the ECJ.

The ECJ decided they were not, and so the liability was transferred to the new employer. The UK court applied TUPE accordingly.

Whether leaving the EU would enable the UK courts to revisit such interpretations – and whether they would wish to do so – remains to be seen.

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Funding and investment

The funding and investment regimes introduced by the Pensions Act 2004 include provisions implementing the 2003 *EU Directive on the activities and supervision of institutions for occupational retirement provision* (“**IORP**”).

Funding

The EU-based parts of the UK funding legislation include the principle that schemes have sufficient funds, the frequency of scheme valuations, and the overarching theme of prudence. Even were the UK to leave the EU, Parliament would probably keep these parts intact for the foreseeable future as they are integral to the overall UK statutory approach to scheme funding.

“Cross-border” schemes (covering both the UK and another EU state) raise different issues. Even if Parliament were to relax the EU-based funding requirements that are imposed on these schemes, this would have no impact if the other EU states’ cross-border requirements still extended to the UK.

Investment

The EU-based parts of the UK investment legislation include elements that are not central to the overall UK framework. The restriction on borrowing and the emphasis on investing in regulated markets are examples of this. Also, the requirement to invest only members’ (and not the employer’s) interests does not sit well with established UK trust law.

Following a UK exit from the EU, amending legislation could be passed to iron out some of these points. However, with all the other consequences of leaving the EU, that might not happen for some time.

Funding and investment cover a wide area, where the prospect of continued EU membership inevitably leaves open the possibility for future change.

For example:

- A revised draft directive to replace IORP (“**IORP II**”) is currently under discussion. On current projections, this is not expected to be finalised sooner than towards the end of this year, with the member states then having 24 months in which to implement it into their national law. The current draft is concerned with governance issues rather than direct funding obligations.
- The European Insurance and Occupational Pensions Authority (“**EIOPA**”) recently decided against the introduction of a new EU-wide funding regime. This came as a relief to many employers and others involved in the operation of defined benefit schemes; there had been concerns that EIOPA’s conclusions might lead to a significant tightening of the existing funding requirements – quite possibly leading to more scheme closures. Clearly that risk has receded, but the point still illustrates that the impact of leaving the EU relates not only to existing EU laws but also to EU laws that might be introduced in the future.
- Questions are sometimes raised as to whether existing UK law goes as far as EU law requires. For example, the ECJ’s 2013 decision in the Irish *Waterford Crystal* case raised concerns as to whether Pension Protection Fund compensation levels were sufficient to meet the UK’s EU Directive obligations to protect employees of insolvent employers.

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Data protection

The Data Protection Act 1998 implements the 1995 *Data Protection Directive*.

In this instance, the UK Parliament would probably be more likely to tighten the current legislation following a UK withdrawal than to relax it.

This is because, by leaving the EU, the UK would also be leaving the EEA. (The UK could perhaps try to stay in the EEA by applying for membership of the European Free Trade Association, but that would not be straightforward.)

By leaving the EEA, the UK would potentially be caught by the EU restrictions on data transfers from the EU to non-EEA countries. These restrictions would not apply, however, if the UK could satisfy the EU Commission that its data protection laws provided “adequate safeguards”.

A recent ECJ decision¹ raises some doubts as to whether the UK would currently be able to meet this test. There is still some uncertainty in this area, but the UK might only be able to surmount this hurdle by implementing the *General Data Protection Regulation* (see right-hand column).

This would be a significant tightening of the UK’s current data protection requirements, outweighing any relaxations to the Data Protection Act 1995 which might be made possible by leaving the EU.

This is therefore an area where the impact of the UK’s leaving the EU is especially hard to predict – not just for pension schemes, but generally.

If the law does become more onerous, those pension schemes where personal data is passed across national borders (because of the locations of its employers or service providers) will be the ones that feel it the most.

The General Data Protection Regulation (“GDPR”)

This is expected to take effect in about two years’ time, and is more onerous than the current requirements. Unlike an EU Directive, the GDPR will become law in all member states without the need for national legislation.

The UK might well not leave the EU until after the GDPR has started to apply to it in this way. Even after leaving the EU:

- the GDPR would still apply (through its continuing application to the remaining member states) to UK transactions with EU citizens; and
- the UK may find itself with little alternative but to implement the GDPR into UK law (for the reasons outlined in the left-hand column).

Transfers of data to the US

There are separate EU developments currently in progress¹ following a recent ECJ decision concerning the legality of data transfers from EU states to the US. This is causing some uncertainty until the position is resolved.

Arguably, leaving the EU might remove this issue so far as data transfers from the UK to the US are concerned (as the UK would no longer be an EU state). However, this does largely depend on whether the UK ends up implementing the GDPR (see above) – particularly if it does so on terms that extend the GDPR protections to UK-to-US transfers.

This is not primarily a pensions problem, but it could be relevant to schemes where personal data is transferred to a US group company or to a service provider operating in the US.

¹ <http://tinyurl.com/h6oy9f5>

Value added tax

The imposition of VAT is an EU law requirement. However, for virtually all of the past 25 years, VAT has been charged in the UK at more than the minimum standard rate required by EU law (and, even before VAT was introduced, the UK imposed a form of consumption tax). It is one of the UK Government's three largest sources of tax revenue.

Consequently, there is no expectation in the short term of VAT being reduced or abolished upon the UK leaving the EU. It might be that, over time, VAT could be overhauled in ways that EU law would not allow (or even replaced by a different tax), but future changes in fiscal policy are especially hard to predict.

An area of specific concern in relation to pension schemes concerns the ability of employers to recover VAT on pension costs. **This is presently subject to some uncertainty²** but on current timescales HMRC is expected to clarify the position before the end of this year (and so well before any UK departure from the EU). This issue has arisen from an ECJ decision (in the *PPG Holdings* case) allowing employers to recover VAT on investment costs, which until then HMRC had not permitted. It is an example therefore of HMRC policy being constrained by EU law – which would cease to be the case following the UK's withdrawal.

There are likely to be further developments over the days and weeks ahead. In the meantime, as always, your usual Linklaters contact will be happy to assist with any questions you may have.

² <http://tinyurl.com/zxea5r3>