News Alert 2017/05

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Article 50 triggered. What does this mean for UK pension schemes?

At a glance

Below we look at what the formal "Article 50" notification of withdrawal given today to the European Union means for the UK pensions market.

The Detail

1. Withdrawal process

Article 50 of the Treaty on European Union provides that, following a notification of withdrawal, a withdrawal agreement shall be negotiated and concluded between the withdrawing state and the EU. The EU treaties will cease to apply to the withdrawing state from the date of entry into force of the withdrawal agreement or, failing that, two years after the date of the withdrawal notification.

So, unless the withdrawal agreement specifies some other date, the UK will cease to be a member of the EU on 29 March 2019.

So, what happens next? Negotiations with the EU will no doubt start soon. Their progress and outcome are currently unknowable. The possibility of another Scottish independence referendum further muddies the waters.

We do know that the UK government's intention is that there will be a "Great Repeal Bill". As well as repealing the European Communities Act 1972 (with the consequence that the European Court of Justice will no longer have jurisdiction in the UK) this will convert the body of EU law into UK law. It is anticipated that this will involve the use of "delegated powers" to preserve EU law as a snapshot just before withdrawal.

A small, but significant part of UK pensions law emanates from EU law. When these laws are preserved in the Great Repeal Act they will be subject to repeal or amendment without reference to the EU.

2. New EU laws that may come into force as we leave

There is one significant piece of EU law impacting UK pensions that we are likely to implement during the two year withdrawal process – the IORP II Directive which became EU law on 13 January 2017 and for which EU member states have two years to implement into domestic law.

IORP II will have a significant impact on UK pension schemes. For example, there is a requirement to appoint two new roles – a risk manager and an internal auditor – as well as an effective requirement to take environmental, social and governance factors into account for investment decisions.

There are two other pieces of European pensions law in progress at the time of writing which could have an impact on UK pension schemes: the European Market Infrastructure Regulation (EMIR) and the revised Shareholder Rights Directive (SRD II). Our current view is that EMIR will not significantly affect UK schemes, which are in any case exempt until 16 August 2018 and, at the time of writing, it looks very unlikely that SRD II will be adopted in time for the UK to be obliged to implement it before Brexit.

3. Potential changes to UK pension law following Brexit

Although we do not expect any immediate changes to UK pension law and regulation as a consequence of UK withdrawal, there are some areas that may be impacted over the medium term as we outline below.

Cross-border schemes

Current EU rules allow pension schemes to operate across EU borders and specify the requirements for doing so. It is unclear whether or not this may continue post Brexit. Our reading of the EU legislation is that there would be nothing to stop the Irish and UK governments agreeing Anglo-Irish schemes, currently the most common type of EU cross-border scheme; but how this will develop politically is uncertain. Similar considerations would apply if Scotland were to leave the UK and remain in the EU.

Equalising pensions for the effect of unequal GMPs

Much of UK sex equality law comes from the EU. It may be that these laws can be changed post Brexit so that UK pension schemes are expressly relieved of the need to address GMP inequalities, although this might be hard to achieve retroactively. The best hope for a resolution to this issue may be that the UK government provides a workable "GMP conversion" solution regardless of Brexit. The government has recently consulted on such a solution.

Unisex annuities

Since 2012, UK insurers have not been able to use gender as a factor when pricing individual annuities because of EU law. This is an area where the UK government might be minded to abolish the EU requirement in due course.

TUPE

Some of the pension protections when employees are transferred between businesses are uncertain or onerous. This is another area of law that has the potential to be reviewed post Brexit. From a pensions standpoint, leaving the EU would open up the prospect of the UK government being able to clarify the scope of the occupational pension scheme exemption in TUPE.

PPF rules

The benefit design of the Pension Protection Fund is constrained by EU law and is currently being challenged in the European Court of Justice. Leaving the EU may remove EU law restricting flexibility in the PPF rules in future.

VAT on pension costs

VAT is an EU tax, so Brexit may enable changes to UK VAT. This adds to the uncertainty about the VAT treatment of pension costs which is awaiting confirmation from HM Revenue and Customs following European Court of Justice rulings.

4. Scottish independence

Nicola Sturgeon, the First Minister of the Scottish Government, has put into play the question of another referendum on Scottish independence. As we note above in the context of EU cross-border pensions law, if Scotland did leave the UK and remain in or re-join the EU, then very significant issues could be created, including the possibility that UK pension schemes with both Scottish and rump-UK members will have to be separated.

Comment

There may be Brexit-related financial and economic turbulence which affects pension schemes over the short to medium term. However, we do not expect there to be any immediate or direct impact on pensions law and regulation in this timescale, so our message for UK pension scheme sponsors and trustees over this timescale and in this sphere remains "keep calm and carry on". But there is so much uncertainty that a weather-eye must be kept on the political developments as they unfold over the next few months.

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