PensionsEurope Position Paper on Brexit

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About PensionsEurope

PensionsEurope represents national associations of pension funds and similar institutions for workplace and other funded pensions. Some members operate purely individual pension schemes. PensionsEurope has **23 member associations** in 18 EU Member States and 3 other European countries[1].

PensionsEurope member organisations cover different types of workplace pensions for over **110 million people.** Through its Member Associations PensionsEurope represents more than **€ 4 trillion of assets** managed for future pension payments. In addition, many members of PensionsEurope also cover personal pensions, which are connected with an employment relation.

PensionsEurope also has **26 Corporate and Supporter Members** which are various service providers and stakeholders that work with IORPs.

PensionsEurope has established a **Central & Eastern European Countries Forum (CEEC Forum)** to discuss issues common to pension systems in that region.

PensionsEurope has established a **Multinational Advisory Group (MAG)** which delivers advice on pension issues to PensionsEurope. It provides a collective voice and information sharing for the expertise and opinions of multinationals.

What PensionsEurope stands for

- A regulatory environment encouraging workplace pension membership;
- Ensure that more and more Europeans can benefit from an adequate income in retirement;
- Policies which will enable sufficient contributions and good returns;

Our members offer

- Economies of scale in governance, administration and asset management;
- Risk pooling and often intergenerational risk-sharing;
- Often "not-for-profit" and some/all of the costs are borne by the employer;
- Members of workplace pension schemes often benefit from a contribution paid by the employer;
- Wide-scale coverage due to mandatory participation, sector-wide participation based on collective agreements and soft-compulsion elements such as auto-enrolment;
- Good governance and alignment of interest due to participation of the main stakeholders.

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[1] EU Member States: Austria, Belgium, Bulgaria, Croatia, Estonia, Finland, France, Germany, Hungary, Ireland, Italy, Luxembourg, Netherlands, Portugal, Romania, Spain, Sweden, UK. Non-EU Member States: Iceland, Norway, Switzerland.

1. Introduction

PensionsEurope welcomes the agreement reached by the EU and the UK on parts of the legal text of the Withdrawal Agreement covering citizens' rights, the financial settlement, and several other withdrawal issues and the transition. We are pleased about the confirmation that EU citizens coming to the UK will enjoy the same rights as those having arrived before the start of the transition period. We also welcome the removal of article 32, which limits the right of onward movement for UK citizens in the EU27.

On 23 March 2018, the European Council adopted the Guidelines on the framework for a future relationship with the UK after Brexit[2], which now serve as a mandate for the EU to discuss the framework for the future relationship, with the aim of reaching a common overall understanding with the UK. PensionsEurope hopes that this agreement will be found in time.

The purpose of this paper is to highlight the issues that need to be considered within or that will impact on the pension sector. It is important that these issues are dealt with as part of the negotiations and PensionsEurope would be happy to provide input on any technical aspects. A transitional period before the withdrawal of the UK, could be used to finalise some of the detailed issues highlighted in this paper.

2. What would PensionsEurope expect from the Brexit negotiations?

The outcome of the Brexit negotiations will have a significant impact on the pension sectors in the EU and in the UK. The UK has one of the largest funded pension systems in the EU and a significant number of investment managers who provide services to pension funds which operate out of the UK and London in particular. For instance, currently around 45% of IORPs' assets in the European Economic Area (EEA) are from the UK and 37% from the Netherlands[3]. After an envisaged Brexit from the EEA, the Dutch IORPs would represent 67% of all IORPs' assets in the EEA. This would lead to both a proportionality and subsidiarity issue with regard to a European approach on IORPs.

Pension funds would like to see Brexit negotiations concluded in a manner that provides stability, in economic terms and impact on investment markets. This is needed to allow pension schemes to invest in a manner that enables them to have confidence that they will be able to pay out the benefits to members of schemes. In order to do this, it is important that the negotiations are concluded with an agreement. Such an agreement will provide stability to the economy and investment markets. It will be good for the benefits of the employees, the employers who sponsor pension schemes and for the investments made by those schemes.

So far, the negotiators have agreed that it is particularly important to make sure that no citizen will be deprived of his or her rights under the Withdrawal Agreement until a final decision by the competent

[2] See the Guidelines of the European Council on the framework for a future relationship with the UK after Brexit (23 March 2018).

[3] See EIOPA 2017 Market development report on occupational pensions and cross-border IORPs (30 January 2018).

authorities, or a final judgment, on an application made for the 'special status' has been taken[4]. The Withdrawal Agreement will ensure that the same safeguards against any restriction of rights as those provided by the EU law will apply.

PensionsEurope finds it important that the negotiators have agreed that citizens will maintain their right to pensions, healthcare, and other social security benefits, and if they are entitled to a cash benefit from one state, they may generally receive it even if they decide to live in another state. When citizens claim a benefit, also after the UK's withdrawal, previous periods of insurance, work or residence in the EU or in the UK will be taken into account.

PensionsEurope hopes that Brexit negotiators will find an agreement, because if there is no deal agreed it is likely to have a negative impact on economic outlook which will then impact on investment markets and put the funding of schemes under pressure. It would also provide uncertainty for EU citizens working in the UK regarding their own pension rights and social security rights and UK citizens who work in other EU countries.

The following sections contain PensionsEurope's further remarks on various aspects of Brexit negotiations, including individuals, economy, investments, implementation of the IORP II Directive in the UK, and cross-border arrangements.

3. Individuals

Following the agreement on citizens' rights[5], PensionsEurope finds it important to have an agreement on rights of EU individuals who are members of UK schemes and UK individuals who are members of EU schemes. That should cover vesting rights but also how the benefits will be paid. An agreement will also need to be reached to apply to social security benefits (e.g. State Pension).

As part of the 'divorce' negotiations on citizens' rights, the UK and EU have agreed to maintain the current arrangements on indexation of state pensions for UK pensioners resident in the EU and vice versa. In a 'no deal' scenario this agreement would not be enshrined in law. While it is likely that both sides would maintain the arrangement anyway, it is – in theory - possible that indexation could cease or be amended, so this could cause uncertainty among, for example, UK pensioners in Spain or Spanish pensioners in the UK.

4. Potential Impact to Economy and Capital Markets

The EU and the euro have made it easier to invest in Europe, and a growing, developing and stable economy attracts more investments. PensionsEurope hopes that Brexit will not negatively affect the

[4] See pages 6-7 of the Communication from the Commission to the European Council (Article 50) on the state of progress of the negotiations with the United Kingdom under Article 50 of the Treaty on European Union (8 December 2017).

[5] See Joint report from the negotiators of the EU and the UK Government on progress during phase 1 of negotiations under Article 50 TEU on the UK's orderly withdrawal from the EU (8 December 2017).

wider economy and set up new barriers to asset flows in Europe. A strong economy is needed so that sponsoring employers all over Europe can support high-quality workplace pension schemes and a robust financial sector is crucial for pension funds' investments. Once the UK leaves the EU there is likely to be a need for greater development of capital markets outside of the UK.

The overnight imposition of WTO tariffs on UK-EU trade in goods would inevitably cause short-term disruption due to (i) the extra costs of the tariffs themselves and (ii) systems challenges at the borders. The impact over the medium and longer term is less clear and would vary significantly from one sector to another, depending on (i) tariff levels and (ii) complexity of supply chains. Companies with complex, cross-border supply chains (e.g. automotive and aerospace) might face significant extra costs and complexity.

What would be the impact on sectors accustomed to a high degree of EU licensing and regulation (e.g. pharmaceuticals, chemicals)? Again, it would take time to put new systems in place. Cross-border trade in services is relatively limited – apart from financial services. It is likely that there would be a demand/need for better developed capital markets outside of London.

Disruption in the short term would be unavoidable and this is likely to undermine the ability of employers to continue to sponsor and support pension arrangements. Such disruption should be avoided and PensionsEurope stresses the need for a comprehensive and definitive agreement. PensionsEurope also stresses that scheme employers and trustees need to work with their legal, actuarial and investment advisers to consider the risks related to Brexit.

Many of the asset managers that serve pension funds are not based in the country of those funds. These asset managers operate on a passporting basis which permits financial services firms in the EEA to undertake permitted activities in other EEA states. For funds and management companies the key passports are in the UCITS (undertakings for collective investment in transferable securities) Directive and the AIFMD (Alternative Investment Fund Managers Directive), and the MiFID II passporting is particularly important to the provision of investment management services. The passporting provisions in the above-mentioned EU legislations are all quite different. Whether UK firms can continue to operate in other EEA states (and vice versa) depends on the deal. Special arrangements are already in place for Switzerland and Gibraltar. A failure to allow those firms to continue to operate on that basis would cause significant disruption and cost with contracts having to be rewritten. This would be more pronounced for forward contracts.

There will be an impact on bond yields (and probably currency fluctuations) and, therefore, on scheme funding. The funding mismatch means there will be winners and losers, depending on the extent of each scheme's hedging and on how the markets move. Most exchange-traded funds (ETFs) are Ireland or Luxembourg-based and re-domiciling them would crystallise a capital gain – with tax implications.

Some major asset managers have all their UCITS based in Ireland. UCITS are by definition EU domiciled funds with EU domiciled management companies, so without a special deal and changes to UCITS legislation, UK UCITS will no longer be UCITS and UK management companies will no longer be able to be management companies for EU 27 UCITS. Furthermore, possibly it will no longer be possible to sell EU-registered funds to UK investors, and vice versa, post-Brexit. There is no direct regulatory reason why EU27 UCITS should be prevented from marketing to UK retail investors, but however, if UK UCITS can no longer be sold into the EU, there is a political risk that EU27 UCITS will no longer be able to access UK retail investors.

Pension funds' transactions with investment banks are usually subject to UK legislation, as that is where most are based. Uncertainty about the outcome of Brexit negotiations has raised questions about the legal status of derivatives contracts after March 2019. **A 'no deal Brexit' could cost pension funds millions of euros to rearrange derivatives transactions which are currently cleared through London.**

Although pension schemes are not rushing to overhaul their investment strategies, the uncertainty in general has a wider negative impact. The rising uncertainty can confuse even the well-informed investors. Therefore, **in this challenging and uncertain environment, it is of utmost importance that policymakers and supervisors do not pose any unnecessary burden, costs and uncertainty for pension funds. Their consequences would be harmful also for the wider European public, as they would lead to decreasing investments by pension funds in the European real economy that creates jobs and growth. Instead, policymakers should focus on removing the barriers to cross-border investment in the EU.**

5. Implementation of the IORP II Directive in the UK

The IORP II Directive has to be implemented by 12 January 2019 and the UK government is expected to consult on implementation in the first quarter of 2018. However, a 'no deal Brexit' might lead to the government deciding to 'cherry pick' the IORP II Directive. For example, the UK might drop the plan for schemes to conduct Own Risk and Solvency Assessments but go ahead with the new requirement for schemes to send annual statements to deferred members.

PensionsEurope stresses that schemes will have to start preparing for the IORP II Directive well ahead of the implementation date – probably in the middle of 2018. So, they might well be committed to the new IORP II Directive requirements anyway – regardless of the course of Brexit. In theory, not being subject to the IORP Directive might mean the UK would adjust the regulatory framework on issues such as investment or the PPF. In practice, given that the IORP framework is fairly high-level, it is unlikely that no longer being subject to it would make a significant difference.

Other EU legislation: The UK is highly likely to press ahead with GDPR implementation regardless of the course of Brexit, so 'no deal' will make little difference on this front. The proposed Pan-European Personal Pension (PEPP) would most probably not be available in the UK under a 'no deal Brexit'.

6. Cross Border Arrangements

There were 73 active cross-border IORPS at the end of 2017[6] and the UK was the Home Country to 19 of these and a Host Country to another 29. **There will need to be a protocol as to how these cross-border schemes will operate post Brexit.**

After a 'no deal Brexit' cross-border schemes serving members in the UK and an EU Member State would no longer be 'cross-border' schemes for the IORP Directive purposes, as they would no longer have active members in more than one EU Member State.

[6] See EIOPA 2017 Market development report on occupational pensions and cross-border IORPs.