**The Slaughter and May Podcast**

**Preparing Pension Schemes for Brexit Podcast**

Hello my name is Richard Goldstein, I'm a consultant and head of pension knowledge here at Slaughter and May. In this podcast, Brexit pension scheme preparedness, I'm going to provide an update to consider the actions pension schemes should be taking in preparation for 1 January 2021. This podcast is split into 3 sections, the first one covers issues for all pension schemes, the second section covers issues of defined benefit pension schemes and the third section briefly covers issues for the defined contribution schemes.

First I wanted to provide a little bit of background. With the 30 June 2020 deadline, for extending the implementation period having now past, 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 minimum-deal scenario following the end of the implementation period on 31 December 2020. I ought to say that 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 will convert into UK legislation 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 already enshrined to UK law. After the end of the implementation period, there will only be limited circumstances in which the Court of Justice of the European Union has jurisdiction and the UK Courts will to some extent be bound by past decisions. It also seems unlikely the UK government would look to repeal significant protections for members that are already now in enshrined into UK law, such as the more recent requirement arising from the IORP Directive. Although, of course, there will be flexibility to allow amendments in future. This is supported by statements 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 the schemes operated.

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. The first issue I wanted cover in respect of all pension schemes is payment of benefits for UK nationals in the European Economic Area or EEA. This covers EU member states as well as Iceland, Liechtenstein and Norway. In the guidance I'm going to refer to also applies to UK nationals who live in Switzerland. The Department for Work and Pensions guidance makes clear the government does not expect the payments of pensions from a pension scheme to overseas members to change from 2021, whatever outcome of negotiations with the EU is. However, the position of purchasing 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 to permit payment to an overseas bank account. 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 scheme being paid into a UK bank account, the bank should contact the member if they need to change the way the 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 to 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 recommendations from the European Insurance and Occupational Pension Authority or IOPA, insurance companies wishing to conduct business with EU residents after Brexit may need to apply for permission from each member state they want to operate within. The FCA has pointed out in its guidance that whether regulatory permission in local EEA jurisdictions 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.

In terms of transfers of benefits from UK nationals to the EEA, there is likely to be limited impact on transfers. Pension schemes can currently make a recognised transfer for tax purposes to a Qualifying Recognised Overseas Pension Scheme or QROPS. One of the exclusions for the tax charge at 25% of the transfer value which applies on such a transfer is whether 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 the exclusion will still apply whether QROPS is in the EEA and the individual is resident in either UK or the EEA after the transfer. The position in relation to transfers for QROPS established in Gibraltar has created some uncertainty given its unique status. However, in Pension Scheme Newsletter 119, HMRC has confirmed the transfers to Gibraltar will be treated as they were before the UK left the EU.

An important issue I wanted to touch on was data protection. A previous government said it would permit personal data to float 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 it is not the case, pension schemes will need to consider what other mechanism they can use to flow the data. In this context, a recent decision of the Court of Justice of the European Union has rather muddied the waters. While the Court did support the use of so-called 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 data security measures were adequate. These standard contractual clauses might currently be used by trustees in the transfer of personal data outside the EEA. If, no EU adequacy decision is forthcoming, the use of these standard contractual clauses may not provide a straightforward solution. The decision may also have wider implications for other mechanisms used for transfer of personal data, such as the use of binding corporate rules governing the transfer of data amongst different group entities.

In the last issue I wanted to talk about in relation to all pension schemes are cross-border schemes. And whilst there are a limited number of these cross-border schemes that are currently in place, it's worth noting that there will be significant changes after 31 December 2020.

Next, moving onto defined benefits pension schemes. The pension's regulator has issued guidance, "prepare your DB scheme for a future EU relationship". Brexit will have an impact on many sponsors and 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 issued a number of pieces of guidance including the possibility of deferral of deficit repair contributions. The statement from the regulator in the Brexit guidance covers 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 Pensions Schemes Bill. Currently making its way through parliament and its consultation on the approach to revising the funding code published for consultation in March 2020 with a draft code to appear later this year or next year for consultation. Pension schemes should not be swayed by short-term movements in markets.

Also on the investment theme, I wanted to cover EMIR, this is the EU regulation on OTC derivatives central counterparties and trade repositories. EMIR requires certain classes of over the counter or OTC derivative 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 unclear 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 that engage in derivatives trading, pension schemes currently benefit from a temporary exemption. No action is required regarding the EMIR pensions exemption from central clearing requirement because the government has confirmed that the EU exemption, in place until at least 18 June 2021, will be introduced into UK law. It is said that the temporary EU exemption for pension scheme arrangements contained in the EMIR refit regulation will be insured and continue to apply to apply to both UK and EEA pension scheme arrangements.

The final item that might be relevant for some DB schemes are those that have an overseas guarantee. There may be an impact for those pension scheme trustees with an overseas guarantee from entity based in the EEA. This is because 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 to 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 investments in the currency of the parent cheaper. This means cash contribution to the schemes may be more affordable.

Finally, a word about defined contribution pension schemes. The guidance from the pension's regulator, the DC schemes focuses on investments, member communications and operations and administrations. The key message highlights the importance of careful communications with members especially those members who are approaching retirement and may be nervous about the impact on their savings. Trustees will also want to monitor the schemes default fund to consider its possible exposure to Brexit related investment risks.

That ends this podcast, I would appreciate any feedback to Richard.goldstein@slaughterandmay.com