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CROSS BORDER SCHEMES

1 INTRODUCTION

The Pensions Act 2004 transposed the cross border requirements of the European Pensions Directive into UK law.

The Department for Work and Pensions (DWP) has now published for consultation draft Regulations which detail the exact conditions and procedures schemes must follow to enter into cross border activity. These Regulations are called The Cross Border Activities Regulations 2005.

A copy of the consultation can be found at:

<http://www.dwp.gov.uk/consultations/2005>

2 KEY POINTS

The headline news on cross border has been about the possibility of “pan-european” pension schemes, but little has been said regarding three potential issues for UK occupational pension schemes:

- Schemes who have members who are currently on secondment outside the UK (see section 5)
- Anglo-Irish Schemes (see section 6)
- Schemes with an overseas parent (see section 7)

But before looking at the potential issues for UK scheme it is helpful to understand how a scheme can become a cross border scheme (see section 3) and what the effect of this designation is (see section 4).

alert

Continued

CROSS BORDER SCHEMES

3 BECOMING A CROSS-BORDER SCHEME

There is no definition of a "cross border scheme". A cross border scheme is an occupational scheme established in one EU state (the home state) which has members who work for an employer in another EU state (the host state) (called "european members").

In the context of a UK pension scheme, a "european member" is a person employed under a contract "sufficiently located" in the EU (but outside the UK) so that he is subject to the social and labour law on pensions relevant to that other EU country (including a self-employed person in such location), excluding any seconded workers. A person or company who employs european members is a "european employer."

Importantly a scheme does not become a cross border scheme automatically, it has to apply to apply to the Regulator to become authorised. We understand that the Pensions Regulator will be publishing guidance on its procedures shortly.

Broadly, schemes will become authorised to operate as cross border schemes on production of their last valuation (this can be on the MFR basis). However, authorisation will be revoked if the "fully funded" requirement is not met by the date outlined in section 4 below.

Until a scheme is authorised it cannot accept contributions from a european employer.

4 EFFECT OF BECOMING A "CROSS-BORDER SCHEME"

Cross-border schemes must be "fully funded" (by which the DWP say they have interpreted as "being able to meet the statutory funding objective").

The draft regulations give existing UK cross border schemes a year from 23 September 2005 to undertake their first valuation. Schemes will then have a further year in which to establish that they are "fully funded" under the

alert

Continued

CROSS BORDER SCHEMES

new statutory funding objective. (We anticipate this is considerably more onerous than the recovery period which might otherwise usually be approved by the Regulator).

Such schemes will also have to undertake annual valuations as opposed to triennial valuations which domestic schemes may adopt.

The DWP would like there to be a year of grace from the valuation before the full funding obligation kicks in, but this proposal needs to be approved by the European Commission. We understand that DWP is in discussion with the European Commission about this at the moment.

The Regulator may consider ring-fencing of assets when looking at the scheme's ability to meet the fully funded requirement. Although, worryingly, the DWP says that "ring fencing is not an option we would choose to impose unless absolutely necessary".

5 MEMBERS ON SECONDMENT

"Seconded workers" are effectively people usually located in the UK and who provide services in the EU but outside the UK and intend to return to work for the same employer in the UK when they finish. Secondments under 12 months are excluded from this definition.

If a scheme has seconded workers, the cross border provisions will apply to it.

This could apply to a lot of UK schemes, and the DWP has been asked to extend the period of secondment beyond 12 months before a scheme is said to have "seconded workers" as members (note that the Revenue previously operated a 10 year limit, before abolishing this altogether in the run-up to the new provisions).

alert

Continued

CROSS BORDER SCHEMES

6 ANGLO-IRISH PENSION SCHEMES

Following various representations, the DWP has acknowledged that there are a number of schemes that operate with members in both the UK and the Republic of Ireland which evolved under the 'split approval' tax regime that ceased in 1994. The DWP is aware of the difficulties surrounding these existing Anglo-Irish schemes which it says "may be considered to be cross border schemes after implementation of the directive".

The DWP is currently in discussions with the European Commission to establish if there is scope for these schemes either to remain outside the ambit of the European Pensions Directive or to lessen the impact of adjusting to the new requirements. There is therefore a possibility that Anglo-Irish schemes may be exempt from the cross border requirements but this is far from certain.

In order to assist the DWP in its discussion with the Commission, Anglo-Irish schemes have been asked to share information with the DWP about their form, membership and funding arrangements.

7 OVERSEAS PARENT

The definition of "European employer" appears to cover all employers who employ persons in the UK and in other member states (regardless of whether the overseas employees participate in the UK pension plan).

Therefore, if a company is based overseas but the UK pension scheme is only for employees of their UK branch, it could be currently be classified as "cross-border schemes" which seems contrary to the intention of the legislation.

alert

Continued
CROSS BORDER SCHEMES

8 WATCH THIS SPACE

The DWP have specifically acknowledged that these regulations are a “work in progress” and subject to change dependent on the responses received from the consultation and their discussions with the European Commission. There is still therefore considerable uncertainty.

The consultation period runs until 30 September 2005. The legislation was expected to come into force on 22 September 2005. This has now been delayed, according to the DWP, until the “Autumn”, but rumours are surfacing in the press that the Regulations could be delayed even further.

9 CALL FOR INFORMATION

In addition, the Pensions Regulator will need to approve all cross-border schemes. The responsibility for obtaining approval rests with the scheme and so the Regulator has asked that all schemes operating cross-border (and wanting to continue to operate cross-border) get in touch. A form for schemes to complete has published on its website.

A copy of the form can be found at:

<http://www.thepensionregulator.gov.uk/pdf/crossBorderForm.doc>

SACKER^S
& PARTNERS

Solicitors specialising in pensions law

Sacker & Partners LLP
29 Ludgate Hill London EC4M 7NX
Tel 020 7329 6699 Fax 020 7248 0552

enquiries@sackers.com
www.sackers.com