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Brexit? How the referendum could affect UK pensions

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Introduction

On 23 June 2016, those eligible will be able to vote on the question “Should the United Kingdom remain a member of the European Union or leave the European Union?”. In the event that the UK does vote for “Brexit”, what could that mean for UK pension schemes?

Could Britain exiting the EU mean a reduction in the amount of red tape for schemes which have grappled with many changes in recent years? The severing of ties with EU lawmakers certainly has the potential to alter the legal landscape. But in reality, what might we expect?

Key points

- The immediate ramifications of a vote to leave the EU are primarily likely to be economic and political.
- Changes to legislation can be expected to take longer to filter through. Areas which could be targeted at an early stage include GMP equalisation and survivor benefits.
- The longer-term impact for pension funds would depend on the terms negotiated by the UK Government in the event of a vote to leave the EU.

Limited immediate impact

Much modern UK law has its roots in the EU and the position for pension schemes is no exception. The “IORP” or workplace pensions Directive, which deals with funding, investment and governance among other things, is one of several EU Directives which has been incorporated into UK legislation and which affect the day-to-day operation of workplace pensions in the UK. Much of the new financial sector regulation, such as EMIR and MiFID II are also key.

The extent to which UK legislation might continue in its current form in the event of a “leave” vote would depend on both the form of the relationship agreed between Britain and the EU and the political appetite in the UK to dispense with or amend existing UK legislation.

Given the focus in recent years by UK legislators and regulators on measures for improving standards for workplace and personal UK pension schemes, it seems unlikely that existing provisions would be stripped out purely because of their origins in EU law.

Likely areas of focus

However, some aspects of UK pensions legislation could be seen as targets for early focus in the event of a "leave" vote. These include:

- Survivor benefits for same sex spouses and civil partners. These are currently restricted to service from 5 December 2005 (and from 6 April 1988 for contracted-out benefits) – see our Alert for more details. But withdrawal from the EU could see new challenges from members on the horizon along the lines of the Walker v Innospec case.

- GMP equalisation. This has generally been thought by successive governments to be a requirement of EU equalisation legislation. However, as GMPs are inherently unequal due to the unequal state benefits on which they are based, there have been significant arguments against equalisation (see our response to the DWP's 2012 consultation for some of these). This issue has been on hold for some years now and could be one which the current Government would be happy to drop.

State pensions

It is generally estimated that around two million UK expatriates currently live in EU countries other than the UK. At the moment, their state pension and healthcare rights are protected.

Should Britain leave the EU, state pension benefits could be frozen, as is currently the case for British pensioners living outside the EU in a country where there is no reciprocal social security agreement under which state pensions are uprated.

Action points: DB schemes

With markets inevitably jittery in the run-up to the referendum, trustees and employers should ensure their ongoing integrated risk management processes are up-to-date.

Among other things, trustees should:

- monitor the scheme's funding assumptions and investment strategy in the light of changing market conditions

- check contingent asset reporting requirements and funding triggers to see whether these might come into play

- keep an eye on the employer covenant and consider whether additional security may be needed

- review the scheme's hedging strategy, including counterparty credit ratings and the scheme's ongoing exposure of derivative and swap contracts against the collateralised liabilities.

Action points: DC schemes

Whilst DC scheme members are responsible for their investment choices, employers should, particularly in the event of a "leave" vote:

- review investment options, including any default funds, to ensure these remain appropriate
- consider additional communications to remind members of the importance of diversity in their investment choices.

Possible timetable

Should Britain vote to leave the EU, it will have two years from the date on which it formally notifies the EU Council of the decision to leave, to negotiate the terms of its withdrawal.

However, many commentators believe that the process of withdrawing from the EU could take significantly longer than this. Extra time can be permitted provided all 27 other member states agree.

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