Summary
- The UK is set to leave the EU on the 29 March 2019 and the likelihood of a 'no-deal' Brexit is edging closer.
- Sponsor covenant poses the biggest threat and pension schemes are being told to have contingency plans in place for all scenarios.
- The knock-on effect of Brexit means that the government lacks the majority and the willpower to give too many man hours to pensions in parliament.

The Brexit pensions gamble

With each passing day the likelihood the UK will leave the European Union without a deal edges ever closer. Theo Andrew explores the risk this poses for pension schemes and what unintended consequences have arisen throughout the process

Deal or no deal? No, not the now defunct Noel Edmond's gameshow, in which contestants were encouraged to blindly gamble on their fate through a more or less arbitrary process of elimination – although it sounds familiar – this time there's a lot more at stake.

Take away a political incentive or two and you might wonder what the difference is between Edmond's show and the way Theresa May is handling current Brexit negotiations. You would also be forgiven for thinking his process might be a more useful one, but as the country edges towards the Brexit cliff, the fate of the UK's pension schemes remains sealed in a big red box.

Over the summer, the no-deal rhetoric ramped up a notch. We had threats to pensioners living in the EU being able to receive payment of their pension, pension schemes shifting the dates of their triannual valuation and delayed policy on home soil. All in all: pension schemes and their members know little about where they will stand.

In a recent PTL survey, Brexit ranked as the third biggest worry for scheme trustees as the end of the negotiation period draws close "without any real clarity around what will happen to the markets".

Sponsor covenant

Perhaps that biggest reason for that worry is the perceived risk to pension schemes from an economic downturn that Brexit could deliver to the UK economy, leading to nervy times for some scheme sponsors, which will inevitably felt by some covenants more than others.

"All of my sponsors are affected in totally different ways and for some it's still great uncertainty," ITS director Rachel Croft says.

Croft points out that this will be particularly tricky for manufacturers that have customers and staff spreading across jurisdictions.

"Conversations will vary hugely depending on the risk. Some organisations are at less of a risk than others, and where it's a significant risk for the organisation then it's tending to be looked at in more detail," she adds.

Depending on where you look, Brexit can be perceived as being both good and bad for the economy.

However, it is hard to escape the fact that the UK is the slowest-growing economy among the G7, growing on average 1 per cent lower that is counterparts, delivering yet more uncertainty to scheme sponsors.

Willis Towers Watson head of scheme funding, Graham McClean, says that despite the fact that the uncertainty means there isn't much schemes can do, they must put in place contingency plans.

"We have seen some companies talk quite publicly about what different Brexit scenarios might mean for them, so understanding those risks between assets and sponsor, because if you are taking a negative hit on investment and sponsor front then you are going to be a lot more concerned."

An obvious danger for some schemes is the effect an economic downturn, and with the Bank of England expected to raise interest rates by another half per cent, schemes could pay the price.

PTL managing director Richard Butcher says it's a tricky one to call: "If long-dated gilts fall we could see an increase in funding deficits at exactly the same time we see a weakening of employer covenants, so you get that pincer movement and it all means tougher negotiations through the next valuation cycle."

According to McClean, one way to mitigate the risk of the "pincer movement" is through the diversification of investments – a strategy, he says, more and more schemes are applying.

Unintended consequences

It was inevitable that Brexit behemoth was likely to have a number of knock-on effects as government resources were swallowed up and political theatrics took on a new level.

Over recent months the industry has seen both the cold-calling ban deadline missed and the pensions dashboard feasibility study delayed, however whether this is down to Brexit divides opinion.

According to Royal London director of policy, Steve Webb, while Brexit legislation has "undoubtedly" squeezed out time for other matters, he believes "there are other factors at work".

"On the dashboard I suspect that the pressure on Department for Work and Pensions to use its IT capacity to sort out the problems with Universal Credit, as well as a genuine debate about how far this project should be a government one.

"On cold calling, the government didn't really want to take action but was ultimately defeated by parliament."

On the other hand, Butcher thinks that a delay in new policy isn't such a bad thing, as the industry takes time to absorb the more recent reforms such as auto-enrolment and pension freedoms.

He says: "Having a quieter period isn't a bad thing when you think about all of the changes made over the past 10 years.

"I think the stuff that's in the pipeline is good quality stuff and it would be a shame to lose things. I don't think any of them are particularly contentious so it would be a shame to lose those things or see them further delayed, but the government is tied up and can't even risk one vote."

One major piece of industry work which has the potential to be affected by Brexit is the DB white paper, as parliamentary time is sucked up elsewhere.

Regulation

An area which is set to stay relatively stable post-Brexit is regulation.

The EU Withdrawal Act enacted in April means much of the regulation that trustees and sponsors already adhere to will be in place by the time the UK leaves Europe, with or without a deal.

Sackers associate director, Ferdinand Lovett, says: "We have a lot of the legislation that is in place now, around scheme funding and the pension directives from Europe. It *[the EU Withdrawal Act]* makes everything into UK law so come exit day next March nothing will change," Lovett says.

Butcher agrees adding that the status quo will be in place for a while as legislators who are now tied up with Brexit will then be preoccupied with negotiating trade deals, with pensions policy "not high up the agenda".

Despite this, over time there could be government appetite to amend, remove and change legislation, this however will be "subject to political appetite and parliamentary time", Lovett argues.

In June, the Association of British Insurers director general Huw Evans highlighted the risk of pensioners living in Europe not being able to receive their pension payments in the case of a no-deal Brexit, a position he hopes does not come to fruition.

Even if this were the case, Willis Towers Watson senior consultant Mark Dowsey says he has a degree of confidence that the UK and the European Union will be able to work together to find a "workable solution".

However, it is this sort of scenario that highlights exactly the problem Brexit poses for pension schemes. While there may well be a number of positive outcomes for schemes and their members, it is the mitigation of risk against the unknown which is posing a headache for the many.

Written by Theo Andrew