Summary
• The signing of the UK-EU Trade and Cooperation Agreement does not mean trustees' Brexit duties are over.
• Even if trustees have had Brexit on their risk registers for some time, they are in a better position now to identify the main risks to keep an eye on.
• There are key areas that trustees can and should be looking at right now and into 2021, all against a backdrop of the Covid-19 environment.

Brexit: Crossing the finishing line

Francesca Fabrizi discovers that, while the Brexit transition period is over, there is still plenty that pension schemes need to do to keep on top of the changes

It's hard to believe that we would long for the days when Brexit was our biggest problem. Pre-Covid, the 'how', 'why' and 'when' of Brexit dominated the headlines, with trustees having to second guess how it would all play out and what it would mean for their schemes.

Now it's finally here, Brexit's potential impact also needs to be considered against a backdrop of a coronavirus-ridden world, where some scheme sponsors that were once deemed unbreakable may sadly be on their knees, and investments that were once booming are looking decidedly questionable.

The first thing to note in all of this, according to Aries Insight managing director, Ian Neale, is that while we have come a long way with Brexit, having had the signing of the UK-EU Trade and Cooperation Agreement (TCA), some sectors are still partly in the dark when it comes to Brexit: "The fact that financial services hardly feature at all in the TCA means that the pre-Brexit uncertainty

continues, for example for pension scheme providers, asset managers and other parties which have, up to this year, had operations in the EU – they no longer have passporting rights.

"UK pension schemes may come under pressure from members resident in EU states to pay pensions into new accounts in banks in EU states, where previously they might have declined requests to do so, following closure of many overseas accounts by UK banks," he says.

Added to this, trustees of schemes that were previously authorised and approved to operate cross-border await guidance from The Pensions Regulator (TPR) on how they should manage the cross-border aspects of their schemes for the post-transition period, continues Neale. These are just a few of the many issues that still need to be ironed out.

Sackers associate director, Nigel Cayless, agrees that, despite its length, the TCA is light on provisions in relation to financial services and investment. The undertakings made in this area are high level and are intended to "secure continued market access", "ensure financial stability, market integrity" and "protect investors and consumers", he explains. "The aim of the UK and the EU is to put a Memorandum of Understanding, establishing a framework for regulatory cooperation on financial services, in place by March 2021, so this will be an area to watch," he adds.

State Street Global Advisors head of policy research, Elliot Hentov, concurs that, although the divorce bill has been signed, the Brexit saga did not end with 2020, with many issues still very much alive, for example in relation to the UK economy.

"Right now, the knock-on effects of Brexit mean that the UK economy is like a car driving with the handbrake on. While the financial services sector has been preparing for a number of years for a hard Brexit, we're now seeing it morph into a siloed issue, with defined areas of the industry, such as European clearing, derivatives trading and others, facing unique challenges thrown up as a result of Brexit and the uncertainty it engenders."

Mercer's chief actuary, Charles Cowling, also warns that schemes need to consider any potential weakness in sterling, "as a result of a perception or reality as to whether the impact of Brexit is good or bad, as well as the potential impact on inflation and interest rates – this is all to do with the strength of the economy and are financial issues trustees need to consider, but are still to be played out."

Better late than never

Despite the uncertainty that prevails, there is still a lot pension schemes can and should be doing now and in the coming months to ensure their schemes are managing Brexit effectively.

"Before going into the detail of what schemes should be doing around Brexit, though, it's important to highlight that schemes should already be looking at this", argues PTL managing director, Richard Butcher. "Brexit may not have a direct impact on many pension schemes. It may well, however, have an indirect impact on a number of areas that trustees ought to be aware of. If schemes are just looking at this now, they are probably a bit late in the day."

BESTrustees' president, Alan Pickering, agrees that this should already be on pension trustees' agendas: "Pension schemes do not operate in a vacuum. They are part of the remuneration package and therefore will be subject to change if employers' businesses are impacted by Brexit in respect of those who they employ, the territories in which those employees work and the broader impact of Brexit on our economy," he warns.

"All trustees have risk registers. Brexit should already be on that register. Saying that, we can now be more specific in identifying likely risks, thereby allowing us to manage, mitigate or avoid any risks that have a negative potential," he adds.

So, whether you are a trustee who is fully aware of the risks that come with Brexit, or whether you have some work to do on getting up to scratch, there are a number of areas schemes need to keep an eye on; and, importantly, says DLA partner, Matthew Swynnerton, trustees should be prepared to answer any Brexit-related queries from concerned members, now that the transition period has ended.

Covenant review and sponsor strength

First off, the sponsor covenant is a key component in any Brexit assessment. If a scheme's employer group trades heavily with European markets, or if the employer is owned by a European entity and/or the scheme has a European parent company guarantee, then trustees should consider a covenant review, advises Swynnerton. "This would also be helpful in cases where business is likely to move away from the UK. The strength of the employer covenant would inform future investment and funding decisions and it is important to bear in mind that some sectors have been impacted more than others by changing economic conditions," he warns.

Linked to this, he says, trustees should keep in mind sponsors' ability to support their schemes as a result of the economic impact of Brexit. Ensuring that sponsors are able to financially support schemes in the medium to long term is important given that financial markets will be impacted, as well as any general corporate activity that took place across borders. As Swynnerton highlights, this will require schemes to take a look at investment risk, covenant strength, funding and the maturing of the scheme to create plans on how to manage reliance on the employer. "It is also advisable that trustees ask sponsors how they are planning to prepare for any Brexit-related impacts," he says.

Butcher agrees that if you are dealing with a business that is very reliant on overseas trade into Europe or trade out

of Europe, then Brexit is going to have an impact on the covenant, "and the scale of that impact could be everything from relatively trivial to capable of killing off the sponsor", he warns. "You therefore need to address that appropriately."

Investment factors

No experienced trustee will be surprised to learn that market volatility as a result of Brexit can lead to changes in the value of scheme assets and investment returns, especially in the short term. However, says Swynnerton, even though trustees are likely to already be aware of such issues and factored them into risk assessments, reassessing whether risk factors have changed may be worthwhile, taking appropriate financial advice to deal with any issues revealed.

Looking at DB and DC in turn, Swynnerton comments: "For DB schemes, arrangements are long term in nature so the hope and expectation must be that material changes would in time revert to the norm. For DC, careful communication with members may be advisable to potentially ward against knee-jerk reactions. Default arrangements should be reviewed and those approaching retirement might perhaps be warned to consider their position (particularly where their investments are heavily return-seeking oriented)," he says.

Cayless agrees that, like any significant economic event, the impact of Brexit will be an important factor for trustees to consider in both the short and long term. "In particular, we recommend that trustees consider, with their investment advisers, the timing implications of any large-scale fund or investment switches over the next few weeks and months. In addition, they should check with their investment advisers that there will be no impact on their scheme's ability to access European investment funds."

Processing issues

Another area that schemes need to look at closely is the processing of pension payments. "What happens if you have pensions in Europe? What happens if you have staff in Europe? What about the impact of Brexit on the secondment rules? What about the impact of Brexit on paying payrolls to overseas countries?" asks Butcher. "The problem with Brexit is, although the TCA was 1,200 pages long, it contained remarkably little detail. So a lot of the devil is going to come out in the detail in due course and when it comes down to it, we might find things don't work as well as we want them to. Who knows, we might find that European pension payments are being bounced back."

Cowling agrees that, on the operational side, "trustees need to ensure pensions continue on smoothly, especially for members who are of outside of the UK in Europe. There may not be many, but for those few, trustees need to ensure that getting their payments won't be interrupted as it will be a big deal for these individuals if there are any issues".

More specifically, explains Cayless, in the run-up to the end of the Brexit transition period, there were reports that customers of UK banks living in Europe had been informed that their current accounts would be closed after the end of the transition period.

"Although it is not a trustee's responsibility to find out whether the accounts of their EU-based pensioners are going to be closed, they may wish to check what their administrator's processes will be if an account closes and a payment to it is not accepted," he suggests. If a pensioner's UK bank account is closed, he continues, they will need to provide details for a different account – the account they choose may be an overseas one. "In such a case, for example, trustees may wish to check if the administrator will still pay the pension in sterling (meaning the pensioner takes the risk in terms of changes to conversion rates/ any additional charges for making an overseas payment). Trustees may also wish to include a short paragraph making pensioners aware of this matter in forthcoming member communications," concludes Cayless.

Legislation and scheme rules

The impact of Brexit on UK pensions legislation has, at least in the short term, been limited, explains Swynnerton; but in the long term is an area to watch.

Previous EU-based legislation has been retained and incorporated into UK law, including pieces like the GDPR and IORP, while other notable areas of pensions law derived from the EU include equality, scheme funding, the Pension Protection Fund (PPF) as well as many member protections, he explains. "Over the longer term, we can expect a divergence from EU principles, as the influence of the Court of Justice of the European Union (CJEU) caselaw and Brussels-generated legislation lessens, and the UK government amends pensions legislation in line with its own policy development on these issues. It is therefore important to keep up-to-date with any changes," he adds.

In terms of scheme rules, many pension schemes have incorporated EU legislation by specific reference and so these references also need to be updated, says Swynnerton.

Overseas guarantee

One area that will not be relevant for all schemes, but for others absolutely essential, is the impact of Brexit on an overseas guarantee. Swynnerton explains: "For those schemes with English law funding guarantees given by a company incorporated in an EU Member State (or in Switzerland, Norway or Iceland), it's essential to monitor whether the UK manages to sign treaties broadly maintaining the current status quo in relation to cross-border disputes."

The UK is in negotiations on this

matter and since there is not yet a conclusion, there are a number of potential scenarios that could ensue.

Cayless advises therefore that pension schemes supported by guarantees from EU-based guarantors should consider seeking legal advice from local lawyers on the enforceability of the guarantee in the relevant EU country. "Subject to how the guarantee is worded, it may be necessary to adjust the jurisdiction clause in the guarantee. Ultimately, it is likely that the UK will enter into an agreement with all EU Member States to provide reciprocal arrangements for the enforcement of court judgments, but it may be a while before such agreements are signed and become binding," he says.

Data protection

Data protection and transfers of personal data between the UK and the EU is another area pension schemes will need to watch, highlights Cayless. It is worth noting that there is a further transition period in relation to data protection of up to six months. He explains: "This is intended to allow an adequacy decision to be agreed and adopted. In the meantime, pension scheme trustees should ascertain whether any such transfers of personal data take place in relation to their scheme and, if they do, ensure the relevant agreements with their service providers will allow for them to continue on and from 1 July 2021 were an adequacy decision not to be given."

Cross-border pension schemes

TPR has previously published guidance on the issue of cross-border pension schemes in the event of a no-deal Brexit, says Swynnerton, and the law that governed cross-border pension scheme arrangements in the transition period expired on 1 January 2021.

Cayless adds: "We are expecting TPR to publish revised guidance shortly on how trustees of schemes that were previously authorised and approved to operate cross-border should manage the cross-border aspects of their schemes for the post-transition period. Until the regulator issues its revised guidance, it has advised that affected trustees should check with the relevant authority in the EU host member state in which their scheme operates."

There are only around 40 schemes of this nature in total, says Swynnerton, in total so whilst not a key consideration, it is important for those trustees that do handle cross-border schemes," he stresses.

The PPF

The PPF is a creature of EU legislation, however, argues Swynnerton, it is too well-established to be dismantled. Saying that, he adds, "in time, the compensation payable may change – i.e. without the underpinning EU legislation preventing the UK government tinkering with the amount payable per member, albeit presumably at the PPF's request".

Pension schemes with EU-based sponsoring employers, however, should consider taking advice on how their scheme's eligibility for the PPF might be impacted and whether there are any actions they should be taking to protect their members, warns Cayless. "The PPF has given some comfort and confirmed that employers based in the EU will be treated in the same way as non-EU overseas employers always have been. This means that UK courts will have discretion as to whether to accept jurisdiction and grant a winding-up order (enabling PPF entry). This means access to the PPF remains possible for schemes with EU sponsors, but will be more uncertain than it used to be," he warns.

Into 2021

All in all, while UK pension schemes already have their hands full with the heavy weight of Covid-19, as well as the Pension Schemes Bill, which will also be keeping them awake at night, Brexit certainly isn't something they can tick off their 'to do' list anytime soon.

As Pickering recommends: "Well-governed schemes should have robust business plans in place, as well as rapid response mechanisms should it seem likely that such plans might be blown off course. The combination of Brexit and Covid-19 is unprecedented and trustees will need to meet much more frequently than normal as they take stock of the effects of these issues on their employer and the pension arrangements which that employer sponsors.

"We must ensure that we have a robust approach to business as usual which can be fine-tuned to whatever changes await us as 2021 evolves," he concludes.

TPR has published useful guidance on what trustees should be considering in relation to Brexit, covering areas such as investment, employer covenant and administration. This remains relevant despite the transition period having ended. Visit https://www.thepensionsregulator.gov.uk/en/prepare-your-pension-scheme-for-brexit

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