

Pensions Client Group

Review of The Occupational Pension Schemes
(Cross-border Activities) Regulations 2005

A Response to the Consultation on the Success of the
Cross-border Regulations in implementing the Cross-
border Provisions of Directive 2003/41/EC (IORP
Directive)

April 2008

The Review of the Occupational Pension Schemes (Cross-border Activities) Regulations 2005

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Executive summary

The IORP Directive¹ came into force on 23 September 2005 and provides EU Member States, and more recently the European Economic Area (EEA) States of Iceland, Norway and Liechtenstein, with a framework for the operation and supervision of occupational pension schemes.

The Directive lays down specific rules governing the manner in which occupational pension schemes are operated, including how they are funded, the information they must provide to Members, and investment rules. The Directive, through Article 20, was also responsible for introducing new measures regulating the operation of schemes established in one EU Member State where some or all of the Members in respect of which contributions are being paid are subject to the social and labour law relating to pensions of a different Member State. Pension schemes operating in this way are said to be “engaged in cross-border activity”. The cross-border provisions of the Directive were primarily implemented in the UK through sections 287-295 of the Pensions Act 2004 and the Occupational Pension Schemes (Cross-border Activities) Regulations 2005 (SI 2005/3381)².

The IORP Directive provides in Article 15(6) that the European Commission would “with a view to further harmonisation of the rules regarding the calculation of technical provisions which may be justified every two years or at the request of a Member State, issue a report on the situation concerning the development in cross-border activities.” In advance of the Commission’s first report (scheduled for later this year), and in compliance with Davidson Review principles (which recommends that any review of UK legislation should be timed to coincide with any review of the relevant EU legislation) we have carried out our own review of the provisions provided for by the Cross-border Regulations so that we may compare our findings with those of the Commission and other States.

As part of our review, a public consultation exercise was held over the period 10 October 2007 to 4 December 2007. As part of this process, a consultation paper was produced and made widely available. In all, 18 written responses to the Government’s consultation paper were received from organisations with an interest in the Review. A list of these respondents is reproduced at Annex A. The Government would like to thank all those who took the time to contribute to the consultation process.

¹ Directive 2003/41 EC on the activities and supervision of institutions for occupational retirement provision (otherwise known as the IORP Directive)

² In N.Ireland: The Occupational Pension Schemes (Cross-border Activities) Regulations (Northern Ireland) 2005 (SR:2005/581)

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This review summarises the views received and advises on the Government's next steps in light of those responses. The review considers the specific issues key to the cross-border process: the information required at the authorisation and approval process; the definition of cross-border activity; the requirement for schemes to be fully-funded at all times; social and labour law requirements of other Member States; and ringfencing. The review, furthermore, in compliance with the Davidson Review on implementation of EU legislation, makes comparison on implementation of the cross-border provisions with other Member States.

The review considers various options by which the process of entering into cross-border activity may be improved, not simply through regulatory measures, but also, on a practical and procedural level with the assistance of the Pensions Regulator, through further representations to the European Commission, and through discussions with other Government Departments, such as HM Treasury.

The recommendations contained in this review and the next steps can be found at chapter six.

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Chapter one: The Authorisation and Approval Process

1.1 Section 287 of the Pensions Act 2004 and the Cross-border Regulations provide that a scheme based in the UK must be authorised (a one-off general clearance to operate in any Member State) and approved (specific clearance related to a particular sponsoring employer in a Member State) by the Pensions Regulator before it can accept sponsorship from an employer where the scheme Members in relation to that sponsorship are subject to the social and labour law of another EEA state.

1.2 The information a scheme must provide in connection with applications for authorisation seeks to establish that the scheme is generally in a fit condition to expand its operations elsewhere in the EEA. The information a scheme must supply when seeking approval seeks to establish the exact nature of each proposal and whether the experience of those running the scheme is compatible with the proposed operation in the other EEA State (in compliance with Article 20 (4) of the IORP Directive).

1.3 Both processes require that schemes are fully-funded (able to meet the Statutory Funding Objective), (in compliance with Article 16 (3) of the IORP Directive), or in the case of brand new schemes, that they will be fully-funded within 2 years.

1.4 As part of our review we asked you the following questions:

i. *Is the information requested in making applications for authorisation and approval reasonable and appropriate?*

ii. *What are the difficulties in providing this information? How could this be improved?*

iii. *What are the extra costs involved for a scheme which operates cross-border? How might these costs be reduced or efficiencies made?*

iv. *Time taken (from sending application form) to gain:*

(i) authorisation

(ii) approval.

Your responses

Questions i and ii

1.5 Most respondents felt that the information requested in the authorisation and approval process was reasonable and appropriate, although some difficulties were experienced in the process which can be summarised as follows:

The Two Stage Authorisation and Approval Process

1.6 Some respondents questioned the need for a two stage application process for entering into cross-border activity. One respondent asked why approval should be needed for each country where a scheme seeks to operate cross-border. If the aim is to be pan-European, it was suggested that a single approval to operate as a cross-border scheme within the EU should be sufficient.

Information already held by the Pensions Regulator

1.7 One respondent questioned the need to supply information in applications for authorisation and approval which is already held by the Pensions Regulator through schemes' registration process.

Translation requirements

1.8 The requirement to translate documents into the various different languages of the Member States has proved to be an onerous requirement. It was suggested that the whole process needed to be streamlined in order to reduce the translation requirements.

Scheme Information requirements

1.9 The regulations require, as part of the process of applying for approval to operate cross-border, that schemes must summarise details of the benefits offered by the scheme. One respondent suggested that a copy of the scheme rules and Members' booklets should suffice.

Extra costs involved for a scheme which operates Cross-border

Questions iii and iv

1.10 There were no substantive comments provided concerning the time taken for schemes to gain authorisation and approval. On the subject of extra costs resulting from the process of entering into cross-border activity, respondents noted the following:

- The extra costs of being fully-funded and providing yearly valuations.

- The extra costs of ensuring compliance with other Member States' social and labour law.
- The extra costs relating to the translation of other Member States' social and labour law.
- The extra costs involved from the two stage authorisation and approval process and from repeat applications for approval to operate in each individual Member state.
- The extra cost involved for schemes which do not operate cross-border in monitoring secondments to ensure that the cross-border requirements are not triggered.

1.11 In terms of reducing these costs, it has been suggested that:

- i) Translation costs could be reduced if the whole application process was streamlined or if templates produced for standard information, e.g. each Member State's information requirements as part of their social and labour law.
- ii) Different approaches could be adopted to the "full-funding" requirement – these approaches are detailed and addressed in Chapter 3.
- iii) A single approval should be sufficient to operate cross-border.

Government's response

The Two Stage Authorisation and Approval Process

1.12 Whilst it is appreciated that a one stage process might be more acceptable to schemes wishing to enter into cross-border activity, it should be noted that:

- i) Both stages can be completed in one go, and
- ii) each stage serves a different purpose.

1.13 The first stage (authorisation) is a general check to ensure that a scheme is in a fit state to operate cross-border. A scheme can be authorised even if it has no immediate intention to operate cross-border.

1.14 The second stage (approval) ensures, in compliance with Article 20(4) of the Directive, that the experience of the persons running the scheme, the financial situation and the administrative structure are compatible with the operations in the host Member state. Moreover, Article 20(2) requires that a notification is effected when a scheme wishes to accept sponsorship from a sponsoring undertaking located within the territory of another Member State; and 20(3) requires that the following information must be supplied: "host Member state; name of sponsoring undertaking and main characteristics of the scheme". It follows therefore that this will be different according to whether the activity occurs in for example France or Spain. Hence, our view is that, whilst authorisation is only required once, the Directive, through the

notification process, requires application for approval each time a scheme wishes to extend its operations into another State.

Information already held by the Pensions Regulator

1.15 We discussed this issue with the Regulator who advised us that they would look into the possibility of “pre-populating” application forms with the information already held by them. At the present time such a step would be at disproportionate cost considering the minimal number of applications to operate cross-border and for this reason is not viable. However, should this situation change in the future, and the numbers interested in operating cross-border were to increase, we would of course reconsider this option.

Translation requirements

1.16 This issue is dealt with under Chapter three – Social and Labour Law.

Scheme Information requirements

1.17 Much of the information a scheme is required to supply at the approval stage is determined by the Budapest Protocol (see paras 4.3 and 4.4). The requirement to summarise details of the benefits offered by the scheme originates in the protocol. Whilst the protocol may be adjusted, subject to agreement by the competent authorities of the Member States, (for the UK, the Pensions Regulator is our representative), the requirement to summarise details of the benefits offered is not considered to be particularly unreasonable as schemes will already hold this information in other forms (such as scheme rules). We therefore do not intend to ask the Pensions Regulator to seek agreement with the competent authorities of the other Member States for this to be amended.

The Full-funding requirement

1.18 The full-funding requirement is addressed in Chapter two – Achievement of Policy objective.

Monitoring Secondments

1.19 Secondments are addressed in Chapter six – Other issues relevant to the Review.

Establishing a new cross-border scheme to avoid main scheme being subject to full-funding requirements

1.20 This issue is addressed in Chapter two - Achievement of Policy objective.

Chapter two:

Achievement of policy objective – to allow occupational pension schemes established in the UK to be sponsored by employers in other Member States

2.1 We wanted to be able to gauge how successful the Directive, and its subsequent implementation, has been in enabling schemes to provide their services to sponsoring employers located in other Member States (to enter into cross-border activity).

2.2 We asked you the following questions:

i) Has your scheme extended its retirement provision in Europe? Please provide statistical details.

ii) How do you feel about the process? Do the Cross-border Regulations allow schemes to reasonably enter into cross-border activity with European sponsors? If not, what are the inhibitors to entering into cross-border activity?

iii) Are there any other specific reasons why you have not used the process?

Your responses

2.3 A number of your responses to these questions have voiced similar concerns, that rather than enable schemes to extend their retirement provision in Europe, the regulations would appear to have done the reverse, with several schemes removing the cross-border provisions they previously operated for Members located permanently in other States.

2.4 The principal reason why schemes appear to be resistant to being involved in cross-border activity is the Directive's "fully-funded at all times" requirement, which we have implemented as meeting the Statutory Funding Objective (section 222 Pensions Act 2004), requiring yearly valuations and a maximum period where the scheme may be underfunded of no more than 2 years.

2.5 To encourage the establishment of cross-border schemes, it was suggested that the Government might wish to consider permitting schemes to establish a cross-border section of a scheme (where only that section would be required to meet the fully-funded at all times requirement), or to consider permitting a 5 or 10 year recovery period and bi-annual or tri-annual valuations.

2.6 One respondent also suggested that that where contributions from a European Employer are being received in respect of a Qualifying Person to a Defined Contribution section of a scheme only, this should not then require any Defined Benefit section to be fully-funded.

2.7 The requirements to have all plan documents translated into the language of the host country and to comply with the host country's social and labour legislation has proved an inhibiting factor for several respondents.

Government's response

The "Full-funding" Requirement for Cross-border Schemes

2.8 Article 16 (3) of the IORP Directive requires that all schemes who enter into cross-border activity shall "at all times be fully-funded in respect of the total range of pension schemes operated". We appreciate that there is some uncertainty about whether the wording of the directive means the total range of schemes, both cross-border and domestic, which are operated by one pension provider, or the total range of cross-border schemes which a provider operates.

2.9 We also appreciate the difficulties faced by schemes operating on a cross-border basis, especially for example where only a small number of members of a scheme are subject to the social and labour law of another Member State or where such members acquire benefits on a money purchase basis whilst the domestic defined part of the scheme is still required to meet the full-funding requirement. Whilst, at this stage, we do not believe we can provide any definitive solutions to this problem, we will raise this matter with the Commission and seek their views.

2.10 On the suggestion to consider five or ten year recovery periods. The Directive requires that where full-funding is not met, that "*the competent authorities of the home Member State shall intervene in accordance with Article 14*". Article 14(2) confers upon Member State competent authorities the power "*to take any measures including, where appropriate, those of an administrative or financial nature, either with regard to any institution located in their territories or against the persons running the institution, which are appropriate and necessary to prevent or remedy any irregularities prejudicial to the interests of the Members and beneficiaries*". In this respect, it is possible that this non-exhaustive list could be considered to include action similar to that described in Article 16(2) which allows for longer recovery periods.

2.11 However, we also have to consider the intention of the Directive. The Directive sets out that schemes which are operating on a cross-border basis should be fully funded "at all times". We take the view that it is proportionate to allow a brief period when the scheme is not in fact fully funded, provided it is able to return to full funding within a short timescale. We understand that a number of other Member States take

a similar approach. Our current view is that it would not be proportionate to extend this beyond the existing limits, as a lengthy recovery period for cross-border schemes would appear to frustrate the purposes of the directive. We will of course review this position if advice on this point should be received from the Commission.

Compliance with Social and Labour Law and Translation requirements

2.12 This is addressed in Chapter three.

Chapter three: Social and labour Law

3.1 When a UK based occupational pension scheme starts providing its services to a sponsoring employer with Members who are subject to the social and labour relevant to occupational pensions of another Member State, it is required to comply with that Member State's social and labour law (as supplied by the competent authority for occupational pensions in that Member State). This is a requirement of Article 20(9) of the IORP Directive.

3.2 We wanted to know whether this requirement was placing any unreasonable demands or possibly demands that can not be complied with on schemes exporting their services. We therefore asked you:

- *Has there been any difficulty in complying with host Member State social and labour law? If so, what were the problems? Please provide details.*

Your responses

3.3 For schemes that have decided not to enter into cross-border activity or to withdraw their cross-border provisions, there has been general concern that the work involved in understanding and meeting the social and labour law requirements of every Member State would be too onerous. Moreover, it was felt that there would be too great a risk that a requirement would be missed. In addition, it was felt that there might be a requirement that the UK pension schemes could not or would not want to meet.

3.4 A significant reported difficulty concerning social and labour law is that many Member States, in addition to the requirements of what must be disclosed to Members in compliance with Article 11 of the Directive (information to be given to Members and beneficiaries), require a significant amount of additional information to be disclosed to Members. The UK, it should be noted, does not place such extra demands in its social and labour law, but simply relies on other Member States to comply with Article 11. Both providing and translating this information can be an onerous task for schemes and it has been suggested that the European Commission might wish to negotiate with relevant Member States with a view to drawing up a consistent set of rules of what must be disclosed to whom and when. It was furthermore suggested that these rules could then be used to draw up template documents in each of the relevant languages.

3.5 One respondent was concerned that the Directive provides no measures to force a particular Member State to divulge the social and labour laws that it requires to be met if Members from its jurisdiction are to be covered. This leaves a scheme in the invidious position that it can (lawfully) accept contributions in relation to Members

from the host state, but it is not absolved from the requirement to comply with legislation about which it (potentially) knows nothing.

3.6 An example was provided where one Member State, in providing details of its social and labour law, simply provided copies of all pensions, employment and social security law in that Member State. This resulted in the scheme concerned incurring substantial costs in having to distil the information provided into what had to be done in practice.

3.7 One respondent suggested that it would be helpful if a list of compliance issues for each Member State was made generally available with a commentary from the Pensions Regulator highlighting areas where UK pension schemes may need to make adjustments.

3.8 Finally, it was pointed out that any change to a host Member State's social and labour law may require a scheme to subsequently amend its rules in order to remain compliant with that Member State's laws. This, it was mentioned, is no light undertaking for a scheme because these rules are built into the systems and administration platforms upon which the scheme is administered (e.g. by an insurer or specialist pension scheme administrator).

Government's Response

Social and Labour Law

3.9 The Government appreciate that the requirement to comply with a host state's social and labour law can be a significant inhibitor for any scheme seeking to operate cross-border or wishing to expand its cross-border activities to other Member States. Certainly where some Member States have decided to include the whole raft of their pensions, employment and social security law in their social and labour law requirements, this would seem excessive. However, the requirement is one of the fundamental principles on which the Directive is based - subsidiarity, that "Member States should retain full responsibility for the organisation of their pension systems" (recital 9). To some extent, this limits what the Government can do to ease obstacles caused by the social and labour law requirement.

3.10 Both the European Commission and its Committee of Insurance and Occupational Pensions Supervisors (CEIOPS) are aware of the potential barriers that social and labour laws might provide. With this in mind, the Commission's working group on pensions (the Occupational Pensions Committee - OPC) are taking on a comparative analysis which should illustrate more clearly the different approaches between states. The Pensions Regulator, as the UK regulatory representative on the OPC, will play an active role in taking that work forward.

3.11 Whilst the European Commission may be able to provide examples of what does and does not constitute social and labour law, the IORP directive does allow states to determine this for themselves. The OPC may be able to encourage agreement amongst Member States as to the correct balance between rules in prudential law and rules in social and labour law, but each state's legislature has the final decision.

Translation requirements

3.12 We discussed the issue of translation with the Pensions Regulator who advised us that they had looked into the possibility of translating authorisation and approval forms. It was felt, however, that schemes operating cross-border would need to be able to work in the host/home state language anyway, so the requirement to translate these forms should not be too onerous.

Other concerns

3.13 We appreciate that the Directive provides no direct measures through which a scheme can require a particular Member State to divulge its social and labour laws. We hope to increase cooperation in this area, and steps are being taken to enable greater accessibility to each Member State's social and labour law.

3.14 CEIOPS is proposing to initiate a link through their website (**www.ceiops.org**) to each Member State's supervisory authority website. Here, it is intended, each Member State will provide details of its social and labour law. The Pensions Regulator has already, by way of example, provided guidance of what each section of UK social and labour law is intended to do:

<http://www.thepensionsregulator.gov.uk/trustees/crossBorder/index.aspx>

Other Member States are being asked to follow suit and during 2008 it is possible that details of most Member States' social and labour law will be available on-line.

3.15 Secondly, the request for the Pensions Regulator to provide a list of compliance issues for each Member State. Whilst this may be commercially desirable, it would be unreasonable for the Regulator to provide a legal interpretation of each Member State's social and labour law. It is for each scheme to interpret the details of each Member State's social and labour law.

3.16 Finally with regard to the need to amend scheme rules on account of subsequent changes to social and labour law. There is a little that can be done to avoid this, but it is hoped that the measures outlined above will reduce the risk of relevant changes to social and labour law passing unnoticed by schemes based in other Member States.

Chapter four: Comparing implementation with other Member States

4.1 The Better Regulation Executive within the Cabinet Office provides guidance on best practice when implementing EU legislation. The Davidson Review sought to ensure that Government Departments do not go beyond the requirements of a Directive when implementing EU legislation. The Review recommends that as part of any review of regulations which have come into force, implementation practices should be compared with at least two other major Member States to draw lessons on methods of implementation and enforcement.

4.2 As part of our review, we were going to consider the implementation procedures of Ireland and the Netherlands. However, we asked you whether, in addition to those Member States, we should make comparisons with any other Member States. Your responses suggested that we should also look at Belgium given that it has recently passed special stand-alone legislation aimed at making Belgium an attractive location for cross-border pension schemes.

Comparing Implementation with the Netherlands and Ireland

Authorisation and Approval Process

4.3 The requirement for schemes to be authorised to operate cross-border is provided by Articles 9(5) and 20(2) of the Directive. The information any scheme located in the EU wishing to operate cross-border is required to provide as part of the authorisation and approval process is, however, largely determined by the Budapest Protocol. The Protocol provides a framework for the cooperation of EU competent authorities (in the UK, the Pensions Regulator) in the implementation of the Directive in relation to the supervision of occupational pension schemes which operate cross border, and has been agreed by all those competent authorities.

4.4 The Protocol provides details of the list of “main characteristics” a pension scheme must provide to the relevant home competent authority when it applies for approval to operate cross-border in another Member State. The requirement for the “main characteristics” of a scheme is a provision of Article 20(3)(c) of the Directive and enables each competent authority to make a decision as to whether “the administrative structure, the financial situation of the institution or the good repute and professional qualifications or experience of the persons running the institution are compatible with the operations proposed in the host Member State” (Article 20(4)). This information (which includes details of the host Member States in which the scheme intends operating and the name of the sponsoring undertaking (employer)) is then passed on to the relevant competent authority in the Member

State in which the sponsoring undertaking is located (the host State), in accordance with Article 20(4).

4.5 The UK's approach to authorisation (and approval) therefore follows a similar approach to that of the Netherlands and Ireland. Each of these approaches broadly seeks to ensure that a scheme is able to meet the Directive's requirements concerning conditions of operation (detailed in Article 9), and that details of the host Member States in which the scheme intends to operate, and the information required by the Protocol in order to determine a scheme's "main characteristics" are supplied before a decision on whether the scheme should be authorised to operate cross-border is made.

4.6 Given that there seems to be little significant difference in the manner in which the Netherlands and Ireland have implemented Articles 20(2) – 20(4) of the Directive, the Government sees little reason to change our approach to this requirement.

The Full-Funding Requirement

4.7 As we mentioned earlier in this report, Article 16(3) of the IORP Directive requires that all schemes who enter into cross-border activity shall "at all times be fully-funded." Member States have taken several different approaches to this requirement.

4.8 In Ireland "fully-funded" means that a scheme is able to meet the Irish "Funding Standard". The Irish Funding Standard is calculated in a similar method to the UK's "Statutory Funding Objective" – the method we use to determine that a scheme is fully-funded. The Irish Funding Standard requires that at the date an actuarial funding certificate is signed, the scheme has assets sufficient to meet its liabilities – in the UK, a scheme is required to have sufficient and appropriate assets to cover its technical provisions (section 222 of the Pensions Act 2004). Where UK cross-border schemes, when underfunded, are permitted a two year period to regain a position of "full-funding", the period allowed for cross-border schemes in Ireland to regain full-funding is decided by the Irish Pensions Board on a case by case basis.

4.9 In the Netherlands, the funding rules require that schemes hold assets worth 105% of their nominal liabilities. This is the so-called "minimum funding level". In addition, a solvency margin has to be maintained as a buffer against risks in order to secure the 105% funding level 'at all times'. As such, in total an average pension fund has to maintain a 130% funding level, the so called 'required funding level'. Unlike UK funding rules, however, where the value of the pension promise is increased on a yearly basis as part of the calculation of the technical provisions (indexation), in the Netherlands this indexation is conditional.

4.10 Where a Dutch scheme does not meet the required funding level, it is allowed a longer recovery period - up to 15 years. However, if the fund does not meet the

minimum funding requirement, domestic schemes are allowed only a three year recovery period, and in the case of cross-border schemes, this period is reduced to 1 year.

4.11 Whilst it is possible to make some comparisons with these other Member States, it is difficult to draw any definitive conclusions from the UK's or any other Member State's approach to the "full-funding" requirement, and for this reason we consider it would be more appropriate to await the Commission's report and their findings on this point before making any further decisions on this issue.

Definition of Cross-border Activity

4.12 The UK's position as far as defining "cross-border activity" is concerned is covered in Chapter five. Comparisons with Ireland and the Netherlands are made in considering our interpretation.

Social and Labour Law

4.13 In chapter three we covered the Directive's requirement that occupational pension schemes operating cross-border must comply with the social and labour law applicable to the Member State in which the sponsoring employer's employees are based, a requirement of Article 20(9) of IORP. In considering which social and labour law we should require other Member States to comply with when the scheme is based outside the UK, we tried to ensure that UK members were offered a similar level of protection as those members of schemes based in the UK, including the requirement to have their pension rights indexed.

4.14 The Government took the view that the UK's list of social and labour requirements should not be excessive given that the Directive has already introduced a uniform set of requirements which schemes based in the EEA must fulfil and which safeguard UK members of schemes based elsewhere in the EEA (e.g. the Directive's requirement for schemes to be fully-funded at all times). However, the protection afforded to UK schemes by the Pensions Protection Fund (PPF), does not apply to schemes established outside the UK and was therefore not included in the list.

4.15 A comparison of the UK's approach with those adopted by Ireland and the Netherlands suggests that each Member State has based its social and labour law on similar principles. For example, each Member State has sought to ensure that where pension rights have accrued these rights are appropriately protected and preserved. However, given that each Member State's social and labour law is particular to the organisation of its occupational pensions provision, it is difficult to draw useful conclusions.

4.16 In defining the UK's social and labour law requirements, we have sought to seek a balance between ensuring that the rights and protections afforded to

members of schemes based in the UK are also ensured for members of schemes based elsewhere in the EEA, and ensuring that these requirements are not so extensive or unworkable as to prevent schemes based in other EEA States from seeking sponsorship from UK based employers.

Comparisons with Belgium

4.17 Within the last 18 months Belgium has introduced a new vehicle specifically designed to meet the needs of the cross-border market, the “Organisme de Financement de Pensions” (Organisation for Financing Pensions) or OFP.

4.18 The OFP is a new separate legal entity designed to host one or more separate pension funds operating in one or more Member States. As the OFP is a new legal entity “*it is not subject to laws applicable to other legal entities*”³. The Belgians have introduced an accompanying new legislative framework with which OFPs must comply.

4.19 The legal framework sets forth simple principles for the organization and the governance structure of the OFP and is based on a qualitative rather than quantitative approach. The framework implements the basic requirements of the IORP Directive.

Authorisation and Approval Process

4.20 In Belgium, like the UK, there is a one-off authorisation process involved for those who wish to provide their services on a cross-border basis, followed by a notification process where a scheme wishes to extend its operations and receive sponsorship from an employer located in another Member State. The information required to operate cross-border follows similar requirements to the UK on account of the need to detail the “main characteristics” of the scheme (Article 20 (3) of IORP refers) which, as mentioned in paragraphs 4.3 and 4.4, are a result of the Budapest Protocol. There seems to be little practical difference in the processes in the UK and Belgium.

The Full-Funding Requirement

4.21 The Belgian approach to scheme funding is similar to the UK’s in that it is a risk based approach focused on the prudent person principle. Each scheme is, like in the UK, required to provide a financing plan based on a prudent, coherent set of assumptions, corresponding to the characteristics of the scheme. OFPs, like UK based cross-border schemes, are required to provide annual accounts and reports covering their entire business including for each separate fund established under them.

³ Extract (Paragraph 2.2) “Belgium, Prime Location for Pan-European Pension Funds” - www.pensionfunds.be/downloads/brochure.pdf

4.22 Where UK legislation enables cross-border schemes that are underfunded to be granted a period of 2 years in which they must retain that full-funding position, Belgian OFPs are required to submit recovery plans for approval within a time period which the Belgian Supervisory Authority stipulates (in practice on a case by case basis). As we mentioned at para 4.11, we would prefer not to draw any definitive conclusions from the UK's or any other Member State's approach to the "full-funding" requirement, but look forward to the Commission's report and their findings.

The Belgian Approach to Cross-border Schemes

4.23 In addition to the introduction of the OFP and the new minimalist principles based regulatory framework, the Belgians have also introduced new tax incentives including Value-Added Tax (VAT) exemptions and low corporate taxes as well as international agreements to avoid double taxation between countries. When making comparisons with the Belgian approach, there are therefore two relevant issues: firstly, whether we can learn lessons from the Belgian approach to regulation of cross-border schemes, and secondly understand further the context of the Belgian changes.

4.24 Looking at the Belgian regulatory approach, establishing a new vehicle for retirement provision and regulatory framework would be a major step to take, and would involve considerable time in terms of planning the new vehicle and carrying out the necessary consultation to ensure that its principles were sound and workable. We are already running a rolling review of private pensions legislation with the aim of reducing burdens on employers providing pension schemes whether operating domestically or on a cross-border basis.

4.25 The Government keeps all areas of the tax system under review and is keen to hear examples from international experience, such as those from Belgium.

Chapter five: Other Issues relevant to the Review

When is a scheme undertaking Cross-border Activity?

5.1 Before the UK agreed the criteria for determining whether or not a scheme was engaged in cross-border Activity, it sought extensive legal advice to ensure that the resulting legislation would fulfil the perceived intentions of the IORP Directive as far as Article 20 and cross-border activity was concerned.

The Government asserts that whether cross-border activity takes place must be determined by checking which Member State's social and labour law is relevant to the employees, and this is reflected in our domestic legislation. This would seem to meet with the Directive's definition of "host Member State":

*"the member state whose **social and labour law** relevant to the field of occupational pension schemes is **applicable to the relationship between the SPONSORING UNDERTAKING and its members.**"*

5.2 The Irish take a similar approach as the UK. For example, an Irish employer with its registered office in Ireland, who has employees based in the UK, who are subject to UK social and labour law and sponsors a scheme registered in Ireland would be considered to be a "cross-border scheme".

5.3 The Dutch, however, take a slightly different approach. They previously considered that it was the location of the sponsoring employer which determined whether cross-border activity took place. However, this was subsequently amended, as it seems that some employers were using a third party to make the necessary contributions, often located in the Netherlands, in order to overcome cross-border requirements, even where the actual employees and employer were located in another Member State.

5.4 Hence their definition has now been amended so that cross-border activity is dependent on the social and labour law applicable to the employees of the scheme, i.e. if this is another Member State's, then cross-border activity is deemed to take place. However, the decision on which social and labour law dictates is determined by the sponsoring employer and the pension scheme based on international labour law.

5.5 In the UK, where an employee is located in another Member State from the scheme, and the employee is covered by the social and labour law of the Member State where he is working, the regulations say cross-border activity is taking place. But the regulations offer some assistance with the task of deciding whether another

Member State's social and labour law applies. If an employee fits the definition of "seconded worker" set out in the regulations, then, even though he is working in another Member State, cross-border activity is deemed not to take place.

5.6 The Government believe that the decisions we have made concerning the definition of cross-border activity are correct and that the definition of "seconded worker" provides employers with a tool to decide whether employees located in other Member States are subject to the social and labour law of that Member State and thus whether their scheme is subject to the cross-border rules. The Government is confident that its current approach represents a pragmatic response to the existing directive. We will, however, continue to work closely with the Regulator, who have been instrumental in bringing cross-border issues, such as this, to the Commission's attention through their focussed pensions work in the CEIOPS committees.

Secondments

5.7 When the Cross-border Regulations were being drafted, the issue of employees who might be posted for temporary periods to other Member States to provide services on behalf of their UK employer was raised, as it was felt that such employees would remain within the UK's social and employment laws, and would not be likely to trigger the cross-border requirements of the IORP Directive.

5.8 Various options were considered in respect of the time period allowed for employees to be "seconded" before the Cross-border Regulations were triggered. In effect, before a placement became "permanent".

5.9 In inserting a definition of secondment into the regulations, Government sought to ensure that the concerns of respondents were taken into account, including concerns relating to the length of the secondment, the possibility of moving from one project to another in another Member State, and the possibility that the employee might retire at the end of the secondment.

5.10 This issue has now been raised again. Respondents in some cases have indicated that they were unhappy regarding the uncertainty over what is meant by the "limited period" mentioned in the definition of "seconded worker" in the Cross-border Regulations. Some, on account of this uncertainty, have taken the measure of removing what were previously considered to be "seconded workers" from their pension schemes.

5.11 It might be useful to put this issue into context. Some Member States have taken a similar approach to the UK on the issue of cross-border activity, basing that decision on which social and labour law applies to the employee. However, they have left it to the sponsoring employer and the scheme to determine which social and labour law should apply (para 5.4 refers). Our view is that it is better to at least

provide employers and schemes with some guidance (through the definition of seconded worker) rather than leave it to them alone to make this decision.

5.12 We believe, as the Pensions Regulator has indicated in their guidance, that “limited period” can reasonably be interpreted as meaning ‘ending on a specified date or when a specific event ends.’ In circumstances where the period is indefinite and there is no indication that the employee will return to the UK after that period (or retire), then the term “seconded worker” is not appropriate. Moreover, we consider that there are likely to be very few circumstances outside of the definition of “seconded worker” where the social and labour law of the host state does not apply, and certainly none that have been brought to our attention where we could put into regulations the same assumptions that the host member state’s social and labour law is unlikely to apply. However, it remains open to pension providers to establish that an individual working in another Member State remains outside of the relevant social and labour law of that state in his or her particular circumstances, and thus that the cross-border pension provisions are not triggered.

Further guidance on seconded workers can be found at:

www.thepensionsregulator.gov.uk/pdf/eUCrossBorderGuidance.pdf

Ringfencing

5.13 The power to “ringfence” is provided by Article 16(3) of the Directive which allows Member States to ring-fence assets and liabilities in order to ensure that schemes will meet the full funding requirement when operating cross-border. However, the exact details of how the ringfencing should take place is not determined by the Directive.

5.14 The ringfencing requirement was implemented in the UK through section 292 of the Pensions Act 2004 and Regulation 15 of the Cross-border Regulations. We considered that ringfencing was appropriate where a scheme’s assets might be misused or misappropriated or where there might be a material threat to the interests of the members. Regulation 15 provides the Pensions Regulator with the option of two forms of ring-fencing. The first option allows for an accounts based division of the assets and liabilities of a scheme attributable to the European employer to whom the ring-fencing notice is given; the second option involves the actual physical separation of assets attributable to a specific European employer.

5.15 Since the Cross-border Regulations came into force, we have made one small amendment to Regulation 15. The amendment ensures that the Regulator may specify the time period within which a scheme must carry out the ringfencing requirement. By providing a time limit within which ringfencing should take place, this provides greater protection for members of a scheme.

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5.16 We see no reason to amend the ringfencing requirement at this stage and will await with interest further possible guidance from the Commission or its working parties on the meaning and scope of ringfencing.

Chapter six: Recommendations and Next Steps

6.1 The Government would once again like to thank you for your helpful responses to our consultation. Your responses have drawn attention to some of the difficulties faced by schemes who have encountered the cross-border process, and by those who may have decided for a variety of reasons not to make use of that process.

6.2 A number of key issues have been raised and actions suggested. These can be summarised as follows:

Authorisation and Approval Process

6.3 It was generally agreed, with one exception, that the information required by the Pensions Regulator in making applications to operate cross-border was reasonable and acceptable. We therefore do not intend to change the requirements for applications at this stage.

6.4 It was suggested that a one stage process for applying to operate cross-border should be adopted. We decided, however, that in order to comply with Articles 20 (2) and 20(3) of IORP, such practices are not permitted.

6.5 One respondent suggested that the Regulator should be able to pre-populate application forms with the information already held by them on the scheme in question. At present, the cost of doing this would be disproportionate in comparison with the small numbers involved who required this service. If, however, numbers were to increase, this option would be reconsidered.

Social and Labour Law – other Member States’ Information Requirements

6.6 Respondents were concerned at the amount of social and labour law some Member States required, including in some instances where Member States had required additional information that should be disclosed to scheme members. It is of course possible in the Directive for Member States to impose these additional requirements where they mirror requirements imposed on the State’s own domestic pension providers [see Article 20(7)], so the opportunity to make national changes is very limited.

6.7 Over the course of the next 12 months, if the Commission’s Occupational Pensions Committee manages to achieve its goal of providing a website link to all states’ social and labour law, transparency should be considerably enhanced. It may also provide a focus for change amongst the Member States themselves, if they can clearly see that their requirements are out of line with other Member States.

6.8 There were also concerns that other Member States' social and labour law was not being sent through when required. Again, the, CEIOPS proposal to initiate a link through their website to each Member State's supervisory authority website will go some way to helping this situation. The intention is that over the coming months, each Member State will provide details of its social and labour law. States that do not do so will be aware that they are not providing the co-operation that the Directive requires them to show.

Full-funding Requirement

6.9 We will, subject to any advice the European Commission may provide, consider whether the Directive's requirement for cross-border schemes to be fully-funded at all times might allow for any different interpretations of what that means. Should any changes be proposed, it is likely that these will be subject to further consultation.

The Definition of Cross-border Activity- "European Employer"

6.10 Subject to any contrary advice that the European Commission may provide as part of their review of IORP, we will not be making any changes to our definition of "European Employer", and our view of when cross-border activity takes place.

Secondments

6.11 The decision as to whether a scheme is operating cross-border is dependent on which social and labour law applies to the members of the scheme. To assist schemes in making this decision we have provided the term "seconded worker" in the Cross-border Regulations.

6.12 Some respondents felt that the term needed further clarification in view of the reference to "limited period" in the definition. We have referred to the guidance already available via the Pensions Regulator website. Our view is that the term cannot be further defined, for instance, to include permitted timescales. Additionally, we consider that the term is supported by sufficient guidance. We also point to the fact that some Member States, whilst adopting the same approach as far as deciding cross-border activity according to which social and labour law applies to members, do not provide such guidance, simply leaving it to the employer and the scheme to make the decision on which social and labour law is applicable.

Next Steps

6.13 We have outlined in this review the areas where changes to the cross-border process might be possible. Should we decide that further legislative changes are possible, we will of course ensure that further consultation takes place. Should any

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further changes result as a course of the European Commission's review of the cross-border process, we will of course alert you to those changes.

Annex A: List of respondent organisations

Actuarial Profession
Aon Consulting
Association of Consulting Actuaries
Association of Pensions Lawyers
Baker and McKenzie
Confederation of British Industry
Law Society of Northern Ireland
Law Society of Scotland
Mercer Ltd
National Association of Pension Funds
Pfizer
PriceWaterhouseCoopers
Slaughter and May
Society of Pensions Consultants
Standard Life
Towers Perrin
Unilever
Watson Wyatt