

EXPLANATORY MEMORANDUM TO
THE OCCUPATIONAL PENSION SCHEMES
(CROSS-BORDER ACTIVITIES) REGULATIONS 2005

2005 No. 3381

1. This explanatory memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. **Description**

- 2.1 These Regulations implement the requirements described in Article 20 of the EU Directive on the activities and supervision of institutions for occupational retirement provision (Directive 2003/41/EC) (otherwise known as the IORP Directive). Article 20 of the Directive seeks to enable an occupational pension scheme established in one EU Member State to be sponsored by employers in other Member States (known as cross-border activity).

- 2.2 The Regulations (and relevant commencement order) also take account of the requirements of:
 - Articles 2 (c) (schemes which are exempt);
 - Article 9 (registration requirements);
 - Article 14 (4) (d) (authority of the Pensions Regulator to restrict an institution's cross-border activities);
 - Article 16(3) (requirement that cross-border schemes must be "fully funded" at all times); and provide details of the method by which schemes may apply for authorisation and approval to enter into cross-border activity.

3. **Matters of special interest to the Joint Committee on Statutory Instruments**

Timing of the Regulations

- 3.1 Although the Directive was required to be implemented in full by 23 September 2005, given the need to take full account of the responses to an extensive consultation, it was not possible to meet this deadline in the case of these Regulations. The Regulations will come into force on 30 December 2005 and will apply to any scheme with its main administration in the United Kingdom which wishes to engage in cross-border activity on or after that date. Regulations which impact on business should normally come into force on either 6 April or 1 October (the two recognised common commencement dates). A

departure from these dates is permitted, however, for Regulations which implement requirements arising from European legislation.

- 3.2 There was particular concern regarding how the Regulations would affect existing cross-border schemes (these are schemes based in the United Kingdom but with members in both the United Kingdom and the Republic of Ireland), and in particular with the Directive's requirement that cross-border schemes must be "fully funded" at all times. The consultation enabled a number of proposals to be considered which will ensure that the Regulations allow these schemes a better transition to the new regime.
- 3.3 The issue of the treatment of seconded workers was another area which raised concern. As the Regulations were originally drafted, schemes were concerned that they would unintentionally become subject to the Regulations by virtue of having a seconded worker in another Member State for a period exceeding 12 months. Amendments to the Regulations have sought to address this concern. An outline of the responses to the consultation and how they have been taken into account is attached at **Annex A**.

4. Legislative Background

- 4.1 The Directive provides a framework for the operation of and supervision of occupational pension schemes. The Directive will only apply to occupational pensions, state schemes and personal pensions are outside its scope.
- 4.2 These Regulations specifically implement the requirements described in Article 20 of the EU Directive. This is the first use of powers under sections 287- 295 of the Pensions Act 2004, which describe the process by which a UK occupational pension scheme may receive contributions from a European employer. These sections additionally provide for Regulations covering:

The definition of "European employer"

- The method by which the trustees or managers of an occupational pension scheme may apply for authorisation to receive contributions from European employers, and the conditions which must be met before a scheme is authorised
- The process and the criteria the Pensions Regulator will use to revoke authorisation.
- The method by which the trustees or managers of an occupational pension scheme may seek approval to receive contributions from a specific European employer, and the conditions which must be met before such approval is granted
- The criteria the Pensions Regulator will use to revoke approval.
- The pensions legislation being modified to ensure that there is compatibility between UK and other member state requirements

- The circumstances under which the Pensions Regulator will consider issuing a “ring-fencing” order and the actions the trustees will be required to take to comply with such an order.
- The requirements of pensions legislation which a scheme based in another Member State must comply with.

4.3 These Regulations form part of a series of Regulations which are due to come into force as a result of the IORP Directive around the end of 2005. The other Regulations include:

- The Occupational Pension Schemes (Scheme Funding) Regulations
- The Occupational Pension Schemes (Investment) Regulations
- The Occupational Pension Schemes (Regulatory Own Funds) Regulations
- The Occupational Pension Schemes (Internal Controls) Regulations

4.4 A transposition note and brief scrutiny history is attached at **Annex B**.

5. Extent

5.1 This instrument applies to Great Britain.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy Background

7.1 The Directive is an important element of the Financial Services Action Plan and represents a first step towards a single market for occupational retirement provision. The cross-border elements of the Directive seek to provide greater freedom for employers to decide where and in which pension schemes they wish to invest.

7.2 The cross-border elements of the Directive seek to provide a standard procedure for occupational pension schemes established in one EU Member State wishing to be sponsored by employers in other Member States, i.e. entering into cross-border activity. If the Government takes no action, i.e. does not legislate to introduce the requirements of the Directive, it risks infraction action (investigation and potentially financial penalties) by the European Commission in the European Court of Justice. The Government has therefore drafted Regulations to implement the cross-border elements of the Directive.

7.3 Until now, UK employers with subsidiaries in other EU member States (other than those with subsidiaries in the Republic of Ireland which have received a level of exclusion due to a reciprocal agreement with Ireland) have established separate occupational pension schemes in each Member State in which the subsidiary was based. The Regulations will now enable multi-nationals operating in a number of

EU States through subsidiary companies to consolidate their pension arrangement in the United Kingdom.

- 7.4 Consultation was undertaken on these Regulations during August and September. There were 54 responses. Responses covered issues related to: definitions; the exclusion for seconded workers; the circumstances in which cross-border activity is deemed to take place; and funding implications for schemes which enter into cross-border activity.

8. Impact

- 8.1 A Regulatory Impact Assessment has been carried out and is attached at **Annex C**.
- 8.2 The impact on the Public sector is Nil.

9. Contact

Richard Jordan at the Department for Work and Pensions, Tel: 0207-962-8201 or e-mail: Richard.jordan1@dwp.gsi.gov.uk can answer any queries regarding the instrument.

Consultation

There was no statutory duty to consult on these Regulations. Consultation was nevertheless considered appropriate in view of the technical nature of these provisions, and their significance for existing cross-border schemes (schemes based in the United Kingdom but with members in both the United Kingdom and the Republic of Ireland), and in particular with the Directive's requirement that cross-border schemes must be "fully funded" at all times. The Regulations could have placed an immediate requirement upon such schemes that they should be "fully funded". We have interpreted "fully funded" to mean that a scheme meets the statutory funding objective as defined in section 222 of the Pensions Act 2004. This would have been impractical as many of these schemes are currently underfunded.

Whilst the Directive does not explicitly allow for a transitional period to reach "full funding", we would argue that the cross-border provisions of the Directive should not be implemented in a way which might harm those it is designed to protect, nor should it be the intention of the cross-border provisions to shut down these schemes, but rather to achieve and protect full funding in the interests of members. We have therefore provided transitional arrangements (a 3 year period) for existing cross-border schemes to reach "full funding".

The consultation period took place in August and September 2005 and involved several meetings with schemes, advisors and the Pensions Regulator addressing key concerns such as those mentioned above.

Outcomes on consultation for the Regulations

Funding

- (i) The length of time allowed for existing cross-border schemes to reach "full-funding" should be extended.
- (ii) The period of time in which a scheme is expected to resecure "full-funding (12 months) is too short and should be extended by a further 12 months.

Secondments

- (iii) The time period allowed for workers to be seconded to another Member State (12 months) was too short and would cause schemes to unnecessarily fall under the Cross-border Regulations (and hence be subject to the "fully-funded at all times" requirements) when this was never the intention. The period should be lengthened to 5 or 10 years.

UK Social and Labour Law- UK law which should be excluded in respect of European members of UK schemes

- (iv) This provision limits certain parts of UK pensions law to UK members of UK schemes. We discussed with the Pensions Ombudsman whether the right to approach the Pensions Ombudsman should be restricted to UK members.

UK Social and Labour Law- Compliance by schemes in other EU Member states

(v) This ensures that schemes based in other member States must comply with certain provisions of UK pensions law in respect of members based in the UK. We discussed with the Pensions Ombudsman whether UK members of schemes based elsewhere in the EU should have the right to approach the Pensions Ombudsman.

Actions

Funding

(i) The Regulations have been amended to allow these schemes a further year, i.e. 3 years from the date the Directive came into force to reach “full funding”.

(ii) The Regulations have been amended so that this period is increased by a further 12 months. The two year period is measured from the effective date of the relevant actuarial valuation. These changes have also been made to the Scheme Funding Regulations.

Secondments

(iii) The Regulations have been amended so that any secondments started prior to the Regulations coming into force will be allowed to run for the duration of that secondment without the Regulations taking effect. Any secondments started after the Regulations come into force will be allowed a limited period (which could be up to 5 years) before the cross-border requirements take effect.

UK Social and Labour Law- UK law which should be excluded in respect of European members of UK schemes (Regulation 14)

(iv) Following discussion with the Pensions Ombudsman, we agreed with his proposal that, as UK schemes are UK regulated and UK enforceable, European members of such schemes should have the right to approach the Pensions Ombudsman. We have therefore not included this legislation in our list. i.e. we have extended the right to approach the Ombudsman to European members of UK based schemes.

UK Social and Labour Law- Compliance by schemes in other EU Member states (Regulation 16)

(v) Following discussion with the Pensions Ombudsman, we agreed, that given the approach we have adopted in (iv), (where the UK scheme with European members is regulated by the UK Regulator), any disputes involving a scheme based elsewhere in the EU should be dealt with by the administration in that member State; as any determinations made in relation to complaints by Cross-border scheme members would be enforceable through the legal framework of the Member State where the scheme is based. Hence we have not included this legislation in our list.

Transposition Note

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

Transposing those parts of the European Union Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision¹ (IORP Directive) which concern Occupational Pension Schemes wishing to enter into cross-border activity in other EU Member States

Article	Requirements	Implementation
2	Sets out the scope of the Directive and identifies institutions to which the Directive shall not apply: 2 (c) institutions which operate on a pay as you go basis.	Commencement order: The exclusion for “pay as you go” schemes is dealt with by a limitation of the schemes to whom the Cross-border Regulations will apply in the relevant commencement order (no 8).
9	Requirement for Member States(MSs) to ensure that: (1) (a) In the case of cross-border activity, the register indicates the MSs in which a cross-border scheme is operating. 5) Conditions of operation for cross-border activity shall be subject to authorisation by competent authorities.	(1) Schedule 1 (6)(6)(a) of the Cross-border Regulations ensures that schemes provide details of the other EU Member States in which they are operating. (5) Implemented by provisions in sections 287(2) and 288 of the Pensions Act 2004 which require the trustees or managers of the scheme to acquire authorisation from the Regulator. Section 288 provides that any application must be made to the Regulator in the prescribed form and the prescribed manner. Regulations 4, 5, 6 and 7 describe the form and manner in which schemes must apply to the

¹ (OJ No. L 235, 23.9.03, p.10)

Article	Requirements	Implementation
		Regulator to be authorised to operate cross-border.
14	<p>Powers of intervention and duties of the competent authorities:</p> <p>4) The competent authority may prohibit or restrict the activities of an institution located in their territories if:</p> <p>d) in the case of cross-border activity, the institution does not respect the requirements of social and labour law of the host MS relevant to the field of occupational pensions.</p>	<p>Section 291 of the Pensions Act 2004 requires trustees or managers of a UK-based pension scheme to act consistently with the requirements of the social and labour law of the host Member State. In cases of non-compliance, the Regulator may issue an improvement notice requiring the trustees or managers to take, or cease to take, such steps as are necessary to ensure compliance with section 291 of the Pensions Act 2004</p> <p>Regulations 8 and 13 enable the Regulator to revoke authorisation and approval of any schemes which fail to comply with the social and labour law of the host Member State. (These powers are provided for under section 288(3) – revocation of authorisation; and 289(4) – revocation of approval).</p>
16	<p>Funding of technical provisions:</p> <p>3) Technical provisions must at all times be fully funded in the event of cross-border activity.</p>	<p>Regulations 7 and 8 ensure that schemes entering into cross-border activity are fully funded by the requirement to obtain annual valuations and to make up within 24 months of the effective date of a deficient valuation any shortfall identified. The fully funded test requires schemes to meet the statutory funding objective as defined in section 222 PA 2004.</p>
20	<p>Cross-border activities:</p> <p>1) MSs shall allow undertakings located</p>	<p>1) and 2) Section 288 of the Pensions Act 2004 provides a power for the Pensions Regulator</p>

Article	Requirements	Implementation
20	<p>within their territories to sponsor institutions for retirement provision authorised in other MSs, and they shall allow institutions to accept sponsorship by undertakings located within other MSs.</p> <p>2) Competent authorities of the home MS shall subject an institution wishing to accept sponsorship from a sponsoring undertaking located within the territory of another MS to prior authorisation. The institution shall notify its intention to accept sponsorship from a sponsoring undertaking located within another MS to the competent authorities of the home MS where it is authorised.</p> <p>3) MSs shall require institutions located within their territories and proposing to be sponsored by an undertaking located in the territory of another MS to provide notification of:</p> <p>a) the host MS(s)</p> <p>b) the name of the sponsoring undertaking</p>	<p>to authorise UK-based pension schemes to operate on a cross-border basis. Schemes wishing to apply to the Regulator for authorisation must do so in the prescribed form and manner.</p> <p>Section 289 of the Pensions Act 2004 provides a requirement for UK-based schemes to notify and obtain approval from the Pensions Regulator each time they wish to take on new business and accept contributions from a different employer in another Member State.</p> <p>Regulations 4, 5, 6 and 7 describe the form and manner in which schemes must apply to the Regulator to be authorised to operate cross-border. Regulations 9, 10, 11 and 12 detail the method by which schemes may seek approval from the Regulator to accept contributions from each sponsoring undertaking located in another Member State. These Regulations include the requirements to provide details of the host Member State in which they will be operating, the name of the sponsoring undertaking and the main characteristics of the sponsoring undertaking.</p> <p>3) As per 20(2).</p>

Article	Requirements	Implementation
20	<p>c) the main characteristics of the pension scheme to be operated for the sponsoring undertaking.</p> <p>4) requirement for a competent authority of the home MS which is notified under paragraph 2, to communicate that information to the competent authorities of the host MS within 3 months, and inform the institution accordingly</p> <p>5) Requirement for the competent authorities in the host MS within 2 months of receiving the information referred to at 20(3), to inform the competent authorities in the home MS of the relevant requirements of social and labour law before the institution starts to operate a pension scheme for a sponsoring undertaking in another MS.</p> <p>Requirement for the home MS to communicate this information to the institution.</p>	<p>4) Section 289(2) of the Pensions Act 2004, requires the Pensions Regulator, on receipt of the notice of intention, to notify the competent authority of the host MS of the contents of the notice of intention, and to notify the persons who gave the notice either that they are approved, or that they are not so approved within three months.</p> <p>5) Section 293(2) of the Pensions Act 2004 places a duty on the Pensions Regulator to provide information of any relevant legal requirements that would affect a cross-border scheme based in another MS to the competent authorities in that home MS. Regulation 16 provides detail of the relevant social and labour law which the Regulator will provide to the competent authority of the home Member State.</p> <p>Section 290(1) of the Pensions Act 2004 places a duty on the Pensions Regulator to provide a UK-based cross-border scheme with information on the requirements of social and labour law of a host Member State, which the Pensions Regulator has received from the competent</p>

Article	Requirements	Implementation
<p>20</p>	<p>6) On receiving the communication referred to in paragraph 5, or if no communication is received from the competent authorities of the home Member State on expiry of the period provided for in paragraph 5, the institution may start to operate the pension scheme sponsored by an undertaking in the host Member State in accordance with the host Member State's requirements of social and labour law relevant to the field of occupational pensions, and any rules that are to be applied in accordance with Article 18(7) and with paragraph 7 of this Article.</p> <p>7) Requirement for an institution to be subject to any information requirements imposed by the competent authorities of the host Member State on institutions located in that Member State.</p> <p>8) Requirement for the competent authorities of the host Member State to</p>	<p>authority in that host Member State.</p> <p>6) Section 287(4) ensures that a scheme may only start operating on receipt of the host Member State's social and labour law or on expiry of the 2 month period after the Regulator has provided the host Member State with the information detailed at 20(3) if no such information is received.</p> <p>Section 291 of the Pensions Act 2004 sets out the duty of trustees or managers of cross-border schemes to act consistently with the law of the host MS.</p> <p>7) Section 291 of the Pensions Act 2004 sets out the duty of trustees or managers of cross-border schemes to act consistently with the requirements of the law of the host MS.</p> <p>8) Section 293(3) of the Pensions Act 2004 sets out the duty of the Pensions Regulator to inform the competent authority in the home MS where there is a significant change in any</p>

Article	Requirements	Implementation
20	<p>inform the competent authorities of the home Member State of any significant change in the host Member State's relevant requirements of social and labour law.</p> <p>9) Requirement for the institution to be subject to ongoing supervision by the competent authorities of the host Member State.</p> <p>Requirement for the institution to comply with the host Member State's relevant requirements of labour and social law.</p> <p>Requirement for the competent authorities of the host Member State to inform the competent authorities of the home Member State immediately of any irregularities.</p> <p>Requirement for the competent authorities of the home Member State to, in coordination with the competent authorities of the host Member State, take the necessary measures to ensure that the institution puts a stop to the detected breach</p>	<p>relevant legal requirements as soon as reasonably practicable</p> <p>9) Section 293(4)(a) of the Pensions Act 2004 stipulates that the Pensions Regulator shall monitor the compliance of institutions that are based in other MSs with the relevant legal requirements,</p> <p>Section 291 of the Pensions Act 2004 sets out the duty of trustees or managers of cross-border schemes to act consistently with the law of the host MS.</p> <p>Sub section 293(4)(b) of the Pensions Act 2004 requires the Pensions Regulator to inform the competent authority of the home MS if the Regulator becomes aware of any contravention by the institution of any relevant legal requirements.</p> <p>Section 288(3) of the Pensions Act 2004 provides for Regulations enabling the Regulator to revoke authorisation to operate cross-border (Art 20(4), (5), (8) and (9)); Section 289(4) of the Pensions Act 2004 provides for Regulations enabling the Regulator to revoke approval to accept contributions from a given European employer Regulations 8 and 13 enable the Regulator to revoke authorisation and approval of any schemes which fail to comply with the social and labour law of the host Member State.</p>

Article	Requirements	Implementation
20	<p>of social and labour law.</p> <p>10) Option for the competent authorities of the host MS after informing the competent authorities of the home Member State, to take appropriate measures to prevent or penalise further irregularities, if, despite the measures taken by the competent authorities of the home Member State or because appropriate measures are lacking in the home Member State, the institution persists in breaching the applicable provisions of the host Member State's relevant legal requirements.</p>	<p>10) Section 293 of the Pensions Act 2004 lays down the functions of the Regulator in relation to institutions administered in other MSs. Where the UK is the host Member State, under section 293 (5) the Pensions Regulator is provided with powers to penalise contraventions of the relevant UK provisions of 'social and labour laws'</p>

SCRUTINY HISTORY

Doc Ref 13420/00, COM(200)507: Proposal for a Directive of the European Parliament and of the Council on the coordination of laws, Regulations and administrative provisions relating to institutions for occupational retirement provisions.

The Government submitted explanatory memoranda to Parliament dated 11 December 2000 and 16 May 2001.

The House of Commons European Scrutiny Committee reported on the proposal and the Governments explanatory memoranda in report no.2, Session 00/01 and in report no. 31, Session 01/02.

The proposal and explanatory memoranda were sifted to Sub-Committee A of the House of Lords European Union Committee and were cleared by that committee following correspondence with Ministers on 17 June 2002.

REGULATORY IMPACT ASSESSMENT**IMPLEMENTATION OF THE CROSS-BORDER REQUIREMENTS OF EU
OCCUPATIONAL PENSIONS DIRECTIVE 2003/41
(IOP DIRECTIVE)****THE OCCUPATIONAL PENSION SCHEMES
(CROSS-BORDER ACTIVITIES) REGULATIONS 2005**

1. This Regulatory Impact Assessment (RIA) assesses the impact of the cross-border requirements of the EU Occupational Pensions Directive 2003/41 (otherwise known as the “IORP” or “Occupational Pensions Directive”) when the relevant provisions come into force. This was scheduled for 23 September 2005, but, the Government has chosen to delay implementation in order to ensure that the circumstances of existing cross-border schemes (Anglo-Irish) are taken into account and the correct approach adopted. The European Commission have been informed of the delay.
2. This RIA builds on the responses received to the consultation the Government carried out during August and September 2005 on the draft Occupational Pension Schemes (Cross-border Activities) Regulations (“the Cross-border Regulations”). A summary of responses to the consultation can be found on the Department for Work and Pensions’ website (www.dwp.gov.uk/publications/2005). The Government’s overall plans for transposition of the cross-border elements of the Directive have not changed substantially as a result of the comments received during the consultation, although some refinements have been made as a result of industry concerns arising from the Government’s proposed way of implementing the Directive’s requirement that schemes operating on a cross-border basis must be “fully funded” at all times.

**PURPOSE AND INTENDED EFFECT OF THE CROSS-BORDER
ELEMENTS OF THE DIRECTIVE****Objective – To allow occupational pension schemes established in the UK to be sponsored by employers in other Member States**

3. The IORP Directive is an important element of the Financial Services Action Plan and represents a first step towards a single market for occupational retirement provision. The cross-border elements of the Directive seek to give greater freedom for employers to decide where and in which pension schemes they wish to participate.
4. The cross-border elements of the Directive will allow occupational pension schemes established in one EU Member State to be sponsored by employers in other Member States. Pension schemes operating in this way are said to be engaged in ‘cross-border activity’.
5. The Government’s aim when transposing this Directive into national legislation, as with any other Directive, is to achieve the objectives of the European measure in accordance with other policy goals such as minimising any burden on business, charities or the voluntary sector. This Final RIA considers the responses to

the consultation on the Cross-border Regulations which recently took place, and provides details of amendments made as a consequence of those replies.

Background

6. The IORP Directive provides a framework for the operation of and supervision of occupational pension schemes in the EU. Member States were required to have transposed the provisions of the Directive into national law before 23 September 2005. The Directive only applies to occupational pensions (second pillar provision). State schemes and personal pensions are outside its scope.

7. Until now, UK employers with subsidiaries in other EU Member States (other than: those that operate in the Republic of Ireland (ROI) which have received a level of exclusion due to reciprocal agreement with Ireland²; and employees seconded from the UK to work in other EU Member States for limited periods) have had to establish separate occupational pension schemes in each Member State in which the subsidiary was based. The Directive will now enable multi-nationals operating in a number of EU Member States through subsidiary companies to consolidate their pension arrangements in one Member State. It will, in addition, allow an employer to locate their pension scheme in another Member State for commercial reasons.

Rationale for Government intervention

8. The cross-border elements of the IORP Directive seek to provide a standard procedure for occupational pension schemes established in one EU Member State wishing to be sponsored by employers in other Member States, i.e. entering into cross-border activity. The cross-border elements of the Directive were due to come into force on 23 September 2005, but, as mentioned in paragraph 1, the Government has chosen to delay implementation in order to ensure that existing (Anglo-Irish) cross-border schemes are appropriately taken into account. It remains the case that if the Government takes no action, i.e. does not legislate to introduce these requirements of the Directive, it risks infraction action by the European Commission in the European Court of Justice. The Government has therefore drafted Regulations to implement the cross-border elements of the Directive.

9. The Regulations take into account the various types of scheme which will be affected by the Directive: existing cross-border cases, i.e. current UK schemes with members in the UK and other EU Member States (in practice only ROI); established UK schemes which may wish to voluntarily become cross-border schemes; and brand new schemes which may wish to become cross-border schemes. They now contain several amendments resulting from comments received during the consultation. These are mostly related to industry concerns arising from the Directive's requirement that schemes operating cross-border must be "fully funded" at all times.

10. The Government mentioned in our original RIA that discussions were taking place with the European Commission to determine whether existing (Anglo-Irish) schemes would be affected by the cross-border provisions of the Directive. The

² Regulations in the UK, and mirroring Regulations in the Republic of Ireland, disapply certain provisions of pensions legislation in respect of schemes based in one country with members in the other.

European Commission has since confirmed that these schemes will be subject to the cross-border requirements of the Directive when these Regulations take effect. The Regulations had, however, already been drafted in anticipation that the Commission would confirm that this would be the case.

OPTIONS

11. Prior to the Government's consultation, two options were considered for dealing with these issues. The consultation has not highlighted any other possible options for implementation, although responses have suggested ways in which the Regulations (option 2) should be revised to implement the Directive. The options were as follows:

Option 1: To do nothing.

Option 2: To legislate to require existing cross-border schemes to establish their funding position and address any shortfall as soon as possible (i.e. within two years of 22 September 2005)

COSTS AND BENEFITS

Option 1 – To do nothing

12. Prior to the consultation, the Government pointed out that if it did not implement the Directive, it would face infraction action by the European Commission in the European Court of Justice. It would still be required to implement as a consequence of that infraction action. It still considers that there would be no obvious benefits in taking this risk. Any UK schemes who wished to enter into cross-border activity would be prevented from doing so. In economic terms, doing nothing would prevent other European employers from possibly participating in UK based occupational pension schemes. It would also prevent multi-nationals from considering the use of the UK as the base for their pension scheme.

Responses from the Consultation

13. There were no responses on this option. For the reasons given in paragraph 12, the Department therefore consider that this is an option which can not be considered.

Option 2 – To legislate using Regulations to require existing cross-border schemes to establish their funding position and address any shortfall as soon as possible (i.e. within two years of 22 September 2005)

14. The Regulations upon which the Government consulted allowed any existing UK cross-border scheme wishing to continue cross-border activity a maximum time period of one year (from 22 September 2005) to choose the first effective date of their first actuarial valuation under the new legislation on scheme funding (Part 3, Pensions Act 2004), and a further year to produce that valuation, in order to establish that they are "fully funded" – able to meet the statutory funding requirement as defined by section 222 of the Pensions Act 2004. For any schemes wishing to enter into cross-border activity, they would need to show that they are "fully funded" before they were authorised to engage in cross-border activity. As this would be a voluntary

activity, such schemes would need to take full account of the more stringent funding requirements applying to cross-border schemes and structure their contributions accordingly.

Estimated costs to schemes

Domestic Schemes

15. Prior to the consultation, it was considered that implementation of the Directive in this area would not impose any new costs. It would only be at the point that schemes wished to become cross-border schemes that they might have to bring forward their funding plans to meet the full funded at all times requirement.

Existing cross-border schemes

16. Prior to the consultation, it was estimated that the (approximately) 90 existing cross-border schemes would have to meet a total, across the board, one-off funding requirement of around £250m over the first year and that if the schemes were smaller than 'average' then the impact would obviously be less.

17. However, it was considered that the actual cost of providing the pension benefits would not be increased; simply the period over which they are being funded would change. Short term expenditure now would be offset by lower payments over the longer term (so that schemes that put more money in now would have to put in less later). These schemes would, however, face the additional cost of undertaking annual valuations. It was estimated (in the Regulatory Impact Assessment of the Pensions Act 2004) that the cost of a valuation for a large scheme is around £10,000. If all 90 of the potentially impacted schemes faced costs of this size (i.e. none of these schemes currently undertake annual valuations) the total additional annual cost (over and above the valuations which would otherwise be required every 3 years) would be in the region of £900,000.

Responses from the Consultation

18. The responses received mainly focussed on the burden placed on them by being "fully funded" and are summarised as follows:

- (i) Schemes and their sponsoring employers should be allowed to sectionalise the parts of their schemes relating to workers in other EU Member States (foreign) and domestic parts, so that only the "foreign" parts are required to be "fully funded".
- (ii) The time period for reaching "full-funding" should mirror that of the draft Scheme Funding Regulations (which allow recovery plans lasting several years).
- (iii) The length of time allowed for existing cross-border schemes to reach "full funding" should be increased from 2 years to 5 years.
- (iv) The estimated average amount for existing cross-border schemes to reach "full funding" - £3m per scheme, is not an amount they would be able to afford.
- (v) Anglo-Irish schemes should be excluded from the implementation of the provisions of the Directive.
- (vi) The period of time in which a scheme is expected to resecure "full-funding (12 months) is too short and should be extended by a further 12 months.

Revisions following the Consultation

19. (i) and (ii), Whilst Articles 16(1) and 16(2) of the Directive detail the funding requirements for occupational pension schemes, which mirror the funding requirements of the Government's new scheme funding regime", **Article 16 (3) requires that any scheme operating cross-border must ensure that "the technical provisions shall at all times be fully funded in respect of the total range of pension schemes operated". The Government is therefore unable to consider either of these suggestions.** The new scheme funding regime allows an underfunded scheme to have a recovery plan covering a number of years. The Government does not believe that this is consistent with the requirement for cross-border schemes to be "fully funded" at all times.

20. (iii) and (iv) The Government does not consider that the implementation of the Cross-border Regulations will involve extra costs to existing cross-border schemes in the longer term, rather it is the shape of the future contribution pattern which will change (paragraphs 16 and 17 refer). However, it does acknowledge that the period we have suggested in which these schemes reach "full-funding" (within 2 years of 22 September 2005) may place an undue financial burden on their sponsoring employer. As a result **we have therefore decided to extend this period by 1 year to 3 years. The period will now end on 22 September 2008.**

21. (v) As we have already mentioned in paragraph 10, following discussions with the European Commission, **this approach is not possible.**

22. (vi) This response relates to the period a cross-border scheme has to reassume a position of being "fully funded" when a valuation shows that they are underfunded (Regulation 8(4) of the draft Regulations). The Government's original position was that a 1 year period should be sufficient to resume "full funding". From the comments we have received, **we acknowledge that this period could be impractical, and have therefore decided to increase this period to 2 years to address the pensions industry's concerns.** This change does not affect our cost assessment, but – as above – simply the shape of the contribution pattern over which full funding should be achieved.

SOCIAL AND ENVIRONMENTAL IMPACT

23. There are no specific social or environmental impacts coming from the proposed implementation of the cross-border elements of the Directive. There is no evidence to suggest that the cross-border elements of the Directive will have any race equality impact.

SMALL FIRMS IMPACT TEST

24. Although some small firms may operate defined benefit (DB) occupational pension schemes, research suggests that they are less likely to do so. Less than 4% of companies with fewer than 50 employees have a salary-related pension scheme³ (compared to more than 50% of companies with 500 or more employees). Also, there

³ Source: Employers' Pension Provision Survey 2003.

are less than 0.1 million (currently active) members of private sector DB schemes in small businesses, compared to around 3.6 million in total for all sizes⁴. Finally, small firms are also less likely to wish to operate a cross-border scheme. Therefore, these provisions are proportionately less likely to impact on small firms.

COMPETITION ASSESSMENT

25. There is no 'market' currently in cross-border pension schemes and therefore the responses to most of the competition filter test, with regard to that market, were negative. One of the aims of the IORP Directive that these Regulations seek to implement is to grow such a market and, as such, they will have an equal impact on all schemes operating in that market. Obviously option 1 would inhibit the scope for growth of the market.

26. Businesses currently operating such schemes do so as part of their remuneration package on a voluntary basis. No information is currently held on the market sectors in which businesses operating schemes on a cross-border basis function. It is therefore not possible to assess which particular sectors will be impacted and the relative size of those businesses affected in comparison with the sector overall. Businesses that operate in more than one Member State will have to fund their pension schemes more stringently than those operating solely in the UK, but this would have to be taken into account, along with a range of other factors, when deciding where to locate employees and what remuneration package to offer them. Existing cross-border schemes will face additional costs in the region of £10,000 per scheme (as detailed at paragraph 17). However, this additional cost and the cross-border pension requirements would be balanced against the competitive advantage and administrative savings which could exist in offering all employees in EU Member States access to the same occupational pension scheme.

ENFORCEMENT

27. Member States are under an absolute obligation to ensure that the provisions of the Directive are carried out. Incomplete compliance with the Directive could risk infraction action by the European Commission in the European Court of Justice. Enforcement of the legislative requirements will be by the Pensions Regulator who will rely on existing whistleblowing requirements and its own investigations. The Pensions Regulator will have the option of revoking authorisation and approval to operate cross-border if a scheme breaches any of the requirements to operate and ultimately to impose civil penalties if schemes continue to operate without authorisation and approval.

SANCTIONS AND MONITORING

Option 2 - To legislate using Regulations to require existing cross-border schemes to establish their funding position and address any shortfall as soon as possible (i.e. within three years of 22 September 2005)

⁴ Source: Government Actuary's Department's Occupational Pension Schemes Survey (2004), and DWP estimate.

28. The Regulations for transposing the terms of the Directive have been drafted so that existing schemes operating in more than one EU Member State will become cross-border schemes, will be authorised by the Pensions Regulator to operate cross-border and will be given until 22 September 2008 to show that their schemes are “fully funded”. The Pensions Regulator will keep a record of the date a scheme was authorised and by which date it must show that it is “fully funded”. If a scheme fails to comply with the requirement by 22 September 2008, the Pensions Regulator will have the option of revoking the authorisation for the scheme to operate cross-border, or, in certain circumstances, of allowing the scheme an additional period to meet the “full-funding” requirement. Trustees of schemes that are not authorised are prevented from accepting contributions. Failure to comply with this will attract civil penalties on the trustees.

IMPLEMENTATION AND DELIVERY

29. The Department for Work and Pensions (DWP) has been working closely with the Pensions Regulator (TPR), who will be responsible for implementing the new policy, to ensure that implementation is carried out efficiently and in a timely way. (TPR, the successor to OPRA, have a wealth of experience in dealing with occupational pension schemes and will have the necessary skills to implement the policy). This has involved:

- DWP’s consultation meetings with representatives from within the Pensions Industry and TPR to discuss what the information requirements should be for schemes wishing to approach TPR for authorisation and approval to operate cross-border.
- Several meetings with TPR representatives to discuss the processes for schemes wishing to be authorised and approved to operate cross-border including information requirements, design of forms and the need to avoid unnecessarily duplicating existing information requirements.
- TPR has organised meetings with stakeholders to address their concerns.
- TPR will launch a consultation with stakeholders detailing its intended approach to the authorisation and approval process and seek responses.
- TPR will provide support to existing cross-border schemes and schemes wishing to become cross-border schemes in the coming months.
- TPR attends the European Commission’s CEIOPS⁵ working group and has played an active role in determining the protocol which will govern its collaboration with supervisory authorities in other Member States in relation to occupational pension schemes cross-border activities.

30. TPR will be responsible for imposing civil penalties on schemes which fail to comply with the requirements of the Regulations as detailed in paragraph 28.

⁵ The Committee of European Insurance and Occupational Pensions Supervisors

Allowing existing cross-border schemes to continue to operate

31. In order that existing cross-border schemes are allowed sufficient time to go through the processes of being authorised and approved by the Pensions Regulator to operate cross-border, the commencement date of section 287 of the Pensions Act 2004 (Occupational pension scheme receiving contributions from European employer) for these schemes will be up to 8 months after that of other schemes (existing domestic schemes and brand new schemes). This is to allow them:

- A maximum of 3 months to apply to TPR for authorisation and approval to continue to operate.
- 3 months for TPR to decide on the authorisation and approval of the scheme (Article 20(4))
- 2 months for the competent authority of the host Member State (the Member State where the sponsoring employer is based) to provide the necessary social and labour law to TPR and for TPR to pass this on to the relevant scheme. (Article 20(5))

REVIEW

32. The Department for Work and Pensions will review these Regulations in 4 years time in order to gauge:

- The efficiency of the authorisation and approval procedure allowing schemes to operate cross-border; and
- The extent to which UK schemes have undertaken cross-border activity through sponsorship by European employers and whether the policy objective has been realised.

SUMMARY

33. Following the responses received to the consultation, the Department has decided to draft the Regulations on the basis of option 2 – requiring existing cross-border schemes to address their funding position as soon as is reasonable (i.e. by 22 September 2008) (there were no responses favouring option 1). The Government cannot consider taking no action (option 1), as there are no benefits from this action.

34. The Department has taken account of the responses received on option 2. These responses have requested: an extension to the period existing Anglo-Irish schemes are given to reach a position of “full-funding”- up to 5 years; and a lengthening of the time cross-border schemes are allowed to fall below the position of being “fully- funded”. The Department, in acknowledgement that these Regulations may place an undue immediate financial burden on cross-border schemes (although this is simply changing the period over which funds will be required rather than the actual amount), has amended the Regulations so that:

- Existing cross-border schemes will be given an extra year to plan to reach the position of “full-funding”, i.e. until 22 September 2008; and

- Any cross-border schemes which fall below the position of being “fully funded” will be given an extra year to resume that position, i.e. 2 years from the effective date of the valuation that reveals the shortfall.

35. Finally, the responses received have not highlighted any other costs involved in implementing these Regulations. Therefore the total additional costs from the requirement to undertake annual valuations (over and above the valuations which would otherwise be required every 3 years) are estimated at around £900,000 per annum across all schemes.

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed by the Minister of State for Pensions Reform, Stephen Timms

Stephen C. Timms

Date 8 December 2005

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