Original Article

European pensions policy and the impact of the EU pensions directive for employers worldwide

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ABSTRACT In recent months, there have been significant changes in European pensions policy and its implementation, which affect (or afflict) employers and employees, and there is more to come. Pensions policy remains important for EU policymakers. This article suggests that opportunities for cost savings, simplification of cross-border arrangements and commercial joint ventures are becoming ever more available. Although the reform of the IORP Directive may look at first instance to be an additional barrier to provision, it might actually prove to be a catalyst for improved regulation.

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INTRODUCTION

If you do not live in Europe, you might be forgiven for thinking that all that Europeans do is squabble about the Euro, decide to extradite each

other's citizens for parking offences, or debate whether the Union should be a federal state somewhat along the lines of the United States or simply a customs union. Surely, the Euro-politicians are too busy with more important things to worry about than the somewhat second order issue of pensions policy.

However, in fact behind the scenes in recent months, there have been significant changes in pensions policy and its implementation, which

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affect (or afflict) employers and employees, and there is more to come. Pensions policy remains important for EU policymakers. From an economic viewpoint, pension assets are considered to involve around one-sixth of EU GDP; from a tax viewpoint, cross-border arrangements can cost national tax authorities significant sums, and from a social policy viewpoint the ageing of European populations poses material challenges to the social fabric of the European Union.¹

More recently, the cost of pension provision has also proved to be an impediment to the restructuring of corporations in the European Union. This article explores some of the issues arising when companies attempt to remodel themselves or are involved in cross-border deals, or where governments attempt to privatise former state bodies, and the background to those issues.

It also considers in particular issues for employers within the European Union, and other employers with subsidiaries there, and covers proposed changes in the regulatory framework, and recent case law in the European Court of Justice.

The main changes cover:

- EU pensions policy in general
- State aid: implications for corporate restructurings following EU rulings on the pension obligations of France Telecom and Royal Mail after privatisation, and the UK NEST scheme
- Consumer protection: the EU distance selling directive and the UK NEST scheme; EU-imposed obligations in multi-employer plans; and EU influences on the definition of defined benefit (DB) and defined contribution (DC) plans
- Collective agreements: ECJ decisions on Dutch employers and collective agreements
- Cross-border mergers and acquisitions: recent UK regulator decisions
- Regulation: the developing influence of European Insurance and Occupational Pensions Authority (EIOPA), and proposed funding changes in Solvency II and IORPS II
- Equal treatment after the *Romer v Hamburg* and *Test-Achats* cases in the ECJ
- Vesting and the consequences of the *Klein v Austria* and *Casteels* cases in the ECJ
- Age discrimination and the *Fuchs* and *Prigge* cases in the ECJ
- Tax: the *Wheels* and *EC v Portugal* cases in the ECJ
- New kinds of schemes designed to avoid EU constraints including collective DC and book-reserve

This note does not look at direct practical steps for employers, but suggests that opportunities for cost savings, simplification of cross-border arrangements and commercial joint ventures are becoming ever more available. Although the reform of the IORP Directive may look at first instance to be an additional barrier to provision, it might actually prove to be a catalyst for improved regulation.

EU PENSIONS POLICY

For several decades, the European Union has been considering what its policy should be in relation to pensions, an increasing concern for an economic area where the population is ageing relatively fast (life expectancy is expected at birth for males to increase by 8 years in the next 50 years), and where the pension systems of both the state and the private sector are coming under strain. In 2012, the number of people over 60 is roughly double that of only 10 years ago. This is proving expensive. Around 10 per cent of GDP is now spent on pensions, predicted to rise to 12.5 per cent in 2060 (with already 15 per cent in Italy).

A consideration of EU policy in 2010 in a Green Paper suggested a raft of changes, some of them major, others simply motherhood and apple pie.² The follow-up White Paper came in February 2012. It was written in the context of an increasingly ageing European population, and consequent pensions and health costs strains on already stretched national budgets. Although individual EU states are largely responsible for their own pension systems, the European Union believes that it can help with legislation affecting internal markets (such as mobility of workers), provide financial support for helping older workers, assist with education and policy co-ordination. The White Paper proposed:

- changes to work place practices to create better opportunities for older workers;

- encouraging private pensions saving through tax and other incentives;
- enhancing the safety of private pensions through better information for pension savers and the pensions (IORP) directive;
- the promotion of mobile working by establishing a cross-border pension tracking service;
- linking retirement age with life expectancy, restricting access to early retirement and closing the gap in pensions provision between men and women;
- supporting pensions reform in the European Union; and
- encouraging the promotion of longer working lives.

The most significant of the suggested policies includes the EC's intention to review the existing European Pensions Directive (also known as the IORP directive), which had originally been intended to liberate pensions provision in the European Union (rather than regulate it). It also had the stated aim of maintaining a level playing field with the funding requirements of Solvency II, following pressure from insurers who wanted pension funds to suffer the same drawbacks that insured pension schemes do. Other specific initiatives included:

- resuming work (in 2012) on a pension portability directive;
- cooperating (from 2012) with Member States to assess and optimise the efficiency and cost-effectiveness of tax and other incentives for pension saving;
- putting forward (in 2012) initiatives to ensure a more effective protection of workers' occupational pension rights in the event of insolvency;
- developing a code of good practice for occupational pension schemes; and
- promoting the development of an EU-wide pension tracking service.

Later in 2012, the EC will release its 2012 Ageing Report, which will assess the economic and budgetary impact of an ageing population and will prepare a Pension Adequacy Report intended to

help Member States to assess the adequacy of their pensions systems for women and men.

It is early days yet to see how various member states will respond. Some jurisdictions will already have largely complied with its aspirations (the UK government certainly considers it has), especially in areas such as restricting access to early retirement, closing the pensions gap between men and women, and encouraging private pension saving through auto-enrolment.

Although much in the White Paper makes sense, many in the pensions industry will question some of its objectives; for example, not everyone will agree the wisdom of setting up an EU tracking service, which could be costly and double up on data already provided by national tracking services.

STATE AID

Over the last decade or so, as countries have been forced to dispose of their previously nationalised industries (or have sought to do so as part of a national policy), the strategy has coincided with the increase in the cost of provision of defined benefit arrangements – which of course many such older legacy companies had become involved in.

Several of the attempts at privatisation could not take place unless the government sellers agreed to retain some or all of the pension costs on their own books, and sold the business clean of pension obligations.

That may have made decent business sense for the governments (or not), but it certainly was considered unfair by private sector competitors. In *France Telecom*,³ for example, in December 2011 the Commission approved the financing of retirement pensions of public service employees working for France Telecom subject to certain conditions. It ruled that the scheme for financing the retirement pensions of France Télécom's public service employees had been compatible with the EU rules on state aid, given that the reduction in pension contributions was offset by a €5.7 billion cash payment from France Télécom to the French State made in 1997. The ruling remained subject to France Télécom bringing the calculation for its contribution fully into line with

that of its competitors from July 2012. The decision did not affect employee contributions or the level of their retirement pensions. Mr Joaquín Almunia, Commission Vice-President in charge of competition policy, commented: 'Maintaining sound competition between the major European operators in the telecoms industry is vital for the competitiveness of our economies and for jobs. After the full liberalisation of markets, the Commission is obliged to be particularly vigilant about the practices associated with the former monopolies'.

Private competing telecoms providers complained and the agreed. The financing scheme in place since 1997 involved a limitation on France Télécom's annual contribution towards the pensions of the staff concerned. By transferring to the French State the expenses it bore, the undertaking has benefited from an economic advantage, which constituted state aid. However, the Commission's investigation found that the financing arrangement was justified, as it released France Télécom from expenses it took on when it was a monopoly operator, especially in view of the fact that it was a public service before 1990 and before the liberalisation of the sector. Moreover, France Télécom had had to make an exceptional contribution of €5.7 billion in 1997, which covered the transfer of part of the expenses to the State. As a result, the financial advantages of the reform have been balanced out to date.

Nevertheless, the financing arrangements in place reduced and limited the annual contribution that France Télécom had previously paid. In addition, certain risks, including a guarantee covering the payment of wages in the event of the bankruptcy of the undertaking, are not taken into account in the calculation, whereas its private sector competitors had to make provision for such risks.

The Commission's decision was made subject to the calculation of France Télécom's annual contribution in respect of its public service employees being brought entirely into line with that of its competitors in the French market. France was required to amend the relevant legislative and regulatory provisions by 31 July 2012.

Similarly, in *Royal Mail*,⁴ the UK government wished to put its postal monopoly up for sale; its

value was around £6B, roughly the value of the associated pension scheme deficits. Before announcing the sale, the government sought the permission of the European Union that selling the company but retaining the deficit did not amount to a state aid and thus amounting to unfair competition. It was held by the ECJ that in the absence of further information, in principle the retention of a pensions deficit by a government as part of its privatisation operations can amount to a state aid. In the event, the European Commission deferred making a final decision pending the delivery of further information by the UK government.⁵

The issue of NEST and state aid is mentioned below.

CONSUMER PROTECTION

Introduction

There has been a consensus (which may have emerged as a result of insufficient argument) that pension scheme systems afford insufficient consumer protection to members. This is despite the fact that in many countries many changes (that is, additions) to regulation have been driven by the EU Pensions Directive, especially in relation to solvency and funding. However, as can be seen below, many of the changes have had unintended consequences, and created more problems for members than if the regulations had not been introduced.⁶

Consumer protection: The distance selling directive and auto-enrolment

One of the methods of consumer protection in the is to ensure that individuals who are sold goods or services other than by than walking into a shop are protected from undue selling pressures.

Pension schemes are also subject to these laws. One scheme that clearly could fall foul of the rules is a new UK quasi-public pension plan. Because of insufficient pension provision through the unfunded state pension scheme, the UK government introduced a new state pension at the end of 2012, known as auto-enrolment, with a default scheme run by the government called

NEST – the National Employment Savings Trust. It requires all employees (subject to their right to opt out) to join a private scheme, with a contribution from the employer, and with total contributions amounting to around 8 per cent of salary. Because it was thought that some private plan managers would refuse to accept very low premiums from lower earners (that is, that there might be a ‘market failure’), the government established a scheme of last resort, with a public service obligation, that is, NEST. Although a state scheme, it is in fact established as a private plan under the law. The issue has emerged as to whether contract-based competitors to NEST might be in breach of the EU consumer protection directives,⁷ which control default sales. It has been said that the EU Commission wrote to the UK government confirming that alternative schemes that use a personal pension arrangement as a nexus are not in breach of the consumer protection legislation, but the letter has not been made available to the public by the UK government, so its terms are not known. NEST itself is not affected, as it is an occupational pension scheme exempt from the EU directives. It is possible that in proceedings for any future breach by an individual or company of the UK auto-enrolment provisions would plead the EU legislation as a defence, and without sight of the Commission letter it might prove effective, rendering the UK system inoperative.

There are also state aid issues in relation to NEST, which has been subsidised with a £600M loan from the government somewhat to the consternation of competing private sector providers, who, however, do not have a public service obligation (that is, to accept even tiny amounts of contribution). The European Union has accepted that it is a suitable case for state aid.⁸

Indemnities from unconnected employers

At the end of 2011, it emerged that the cross-liabilities of multi-employer schemes, partly imposed by the need for guarantee schemes (in the United Kingdom known as the Pensions Protection Fund) driven by the EU Insolvency

Directive,⁹ would or might have unintended consequences.

The Wedgwood Museum in Stoke-on-Trent in England, for example, made headlines by being forced to sell its historic collection of China, masterpieces by Stubbs, Romney and Reynolds, and an archive linked to the nation’s social and industrial history in order to pay unconnected pension liabilities. In *Wedgwood*,¹⁰ it was held that the pottery collection owned by the museum was an asset of Waterford Wedgwood Potteries, which went bust in 2009. The collection is now to be sold to pay off creditors, the largest of which is the Pension Protection Fund (PPF), the UK equivalent of the PBGC in the United States. The ruling was an unintended consequence of safeguards introduced to protect employee pensions after the Robert Maxwell scandal in the early 1990s, but refined by EU requirements since then. The legislation now means any company linked to a pension scheme, in this case the museum, can be held responsible for pension shortfalls created by related (or indeed unrelated) companies. The museum had not been connected to its parent company for almost 50 years, but five of their employees were part of the Pottery Group Pension Plan’s 7000-member scheme. Because those five became employees of the Wedgwood Museum 7 years earlier, the court ruled that the administrators of the museum were now liable for the £134m deficit in the pension fund. The deficit became the museum’s responsibility following the earlier insolvencies of the other Wedgwood group companies, leaving the pension trustees with no option but to claim this amount from the museum as required by legislation.

It is expected that multi-employer plans operated by charities and others will face increasing costs in line with the judgment.

Money purchase and the *bridge* decision in the English Supreme Court

A major issue for company sponsors of pension schemes is the nature of the promise they are involved in making. Most of the EU protective legislation applies to the funding of defined benefit schemes, and its implementation can be

complex. Accordingly, in recent years, employers have made efforts to ensure that their plans are DC and hence outside the regulations. In addition, plan members need to know what kind of scheme they are.

Such efforts are not always successful. Some years ago, in the United Kingdom in a case involving KPMG, the accountants made it clear that although the scheme plan documents seemed to indicate that it was a DC scheme, it was, in fact, because, for example, of the internal annuity provisions that it was a salary-related scheme, which was to the benefit of the members.¹¹ More recently, there was a bitterly fought case about whether a pension scheme was defined benefit or DC because of the EU law on funding and solvency.¹² Many employers have provided what they think are DC schemes, and have limited financial exposure for their sponsors – only to be told by the courts (and the government) that they have in fact a defined benefit scheme. There are additional solvency and funding costs – and additional contributions to the PPF in the United Kingdom as a consequence, not to mention inter-company liabilities for another employer's deficits.

No one would have cared all that much if it had not been for the European Pensions Directive imposing special liabilities on DB plans. Following some long-running litigation, the English Supreme Court in 2011 handed down its judgment in the Imperial Home Décor case (*Houldsworth v Bridge Trustees*), which revolved around the meaning of 'money purchase benefits' (that is, DC). It rejected the government's argument that money purchase benefits must be defined so that a money purchase scheme cannot have a deficit; the Supreme Court held that the two benefits in question under the Imperial Home Décor Pension Scheme (that is, pensions payable by the scheme (by way of internal annuitisation) and benefits with a guaranteed investment return) were money purchase benefits. So annoyed was the government (because they mistakenly believe that the EU will hold them liable for DC pensions deficits) that it amended a new Pensions Act 2011 to introduce a new definition of money purchase benefits. This now

means that some schemes that were formerly treated as money purchase schemes are now required to comply with the statutory funding requirements applicable to defined benefit schemes and to pay the PPF levy.

The definition of 'money purchase benefits' now means that a benefit would only be treated as a money purchase benefit where 'its rate or amount is calculated solely by reference to assets which (because of the nature of the calculation) must necessarily suffice for the purposes of its provision to or in respect of the member'. Pensions in payment are only to be treated as money purchase benefit where they are secured by way of an annuity contract or insurance policy taken out with an insurer and where 'at all times before coming into payment' the benefit fell within the meaning of a money purchase benefit set out above.

The UK Government's priority in introducing this new definition was to ensure that benefits that could develop a deficit cannot be treated as money purchase benefits. This means that some schemes that have formerly been treated as money purchase schemes (but which provide benefits such as those under the Imperial plan that could give rise to a deficit) will now be classed as defined benefit schemes and thus are likely to have to comply with the statutory funding requirements applicable to defined benefit schemes and to pay the PPF levy.

The outcome is that schemes that previously worked well as money purchase schemes are now required to revalue or pay increases in ways that were never intended or funded for.

TAX AND TAX POLICY

Cross-border investments

Cross-border tax freedoms are an essential element of the European dream. Without fiscal non-discrimination, true free trade is hard to achieve. There are two main areas of concern for corporates wishing, for example, to establish cross-border schemes: first, whether there is cross-border relief for contributions and the acquisition of benefits, and, second, whether there is discrimination on cross-border investments.

There have been several cases before the EU Court of Justice over the past 10 years or so that have made it clear beyond any doubt whatever that there must be freedom of establishment across borders without any tax discrimination, and that that obligation applies to pension arrangements.¹³ And equally emphatically, fiscal authorities in member states have made it clear that they intend so far as possible to ignore it, or to work their way round many of the freedoms. They do not want, for example, their citizens to gain tax relief on their contributions to a scheme, and retire to another member state where they may enjoy the benefits tax free. They could always of course enter into double taxation agreements to cover such eventualities, but most countries have neither the time nor the appetite to manage tax issues on pensions in such a manner. Thus, there continue to remain cross-border barriers to tax relief on contributions, despite the cases mentioned and many other challenges made by the Commission to domestic tax authorities.

Similarly, many tax authorities are less than happy about awarding tax reliefs in relation to investments held by foreign pension schemes in their own territories, even though they may give exemption to their own pension schemes. Nonetheless, it is illegal.

One solution being explored by some jurisdictions is some form of tax-transparent pooling arrangements. PSPV, pension fund pooling vehicles, were invented in the United Kingdom, for example, some years ago but were never very successful.¹⁴

Newer tax-transparent vehicles may offer greater potential benefits for EU pension funds and multinational corporate than the UK PFPS arrangements. The United Kingdom itself is planning to introduce new legislation that will enable a new tax transparent fund vehicle, which can be used to create a cross-border collective investment fund, to be established in the United Kingdom. The primary objective behind the introduction of these new tax transparent funds is to ensure that the United Kingdom remains competitive in the asset management market alongside other European jurisdictions.

This primarily stands to benefit UK pension funds as investors, but in addition and more importantly the funds should also offer opportunities for global organisations to establish a cross-border collective investment fund for their global pension arrangements. Benefits include:

- domestic pension schemes stand to benefit from increased access to larger tax-efficient asset pools in the domestic jurisdiction;
- Introduction of tax transparent funds will benefit the domestic economy;
- multinational corporations could use these new structures to set up a tax transparent collective investment fund for their global pension arrangements.

In 2011, for example, the UK government announced¹⁵ that it would introduce a new, regulated tax-transparent fund vehicle to facilitate the setting up of pooled 'master funds' under the EU Undertakings for Collective Investments in Transferable Securities IV Directive. Later, it published a consultation document, which included draft legislation providing for the establishment and authorisation (by the UK Financial Services Authority) of UK contractual collective investment schemes, as well as discussing regulatory issues and their proposed tax treatment.¹⁶

Similar arrangements are offered by other EU jurisdictions, but the United Kingdom has no authorised tax-transparent fund structure available to compete with Luxembourg FCPs (*fonds communs de placement*) and Irish CCFs (common contractual funds). The proposed tax-transparent funds are intended to remedy this.

The result of the fund being tax-transparent is that it is the investors in the fund who pay any tax, depending on their circumstances, not the fund itself. Therefore, the fund will not be liable for corporation tax, income tax or capital gains tax. Investors will also look through it for their own income tax purposes, so they will be subject to tax or exempt from tax on the income as if they owned their proportionate share of the fund's assets. This is significant for UK pension schemes that are tax-exempt, as it will result in

the tax benefits that they currently enjoy carrying through to the assets held in the fund on their behalf.

In addition, it is expected that co-ownership funds will generally be treated as tax transparent in other jurisdictions so that their investors can benefit from double tax treaty relief on non-UK source income.

A multinational corporation with pension schemes in a number of jurisdictions might also wish to set up a 'private' tax-transparent fund using this structure, invested in by the various group companies' occupational pension schemes. There would be set-up costs and running costs as the fund would need to be UK FSA authorised. However, the benefits of asset pooling in this way include:

- reduced management fees through economies of scale;
- greater investment diversity by virtue of the larger asset pool;
- potentially enhanced returns;
- reduced administration costs through economies of scale.

As these funds will be tax-transparent in the United Kingdom, the various overseas pension investor funds will not be taxed in the United Kingdom, but will still (if applicable) pay tax on the investments in accordance with their local tax laws. They will also be able to benefit from any applicable double tax treaty relief available between their home country and the country in which the investments are located.

VAT

One of the recurrent issues with value added taxes is the extent to which it applies to the benefits, contributions and investments of pension funds. VAT is governed in EU member states by a number of EU VAT Directives, which deal *inter alia* with the application of VAT on investment management. In *Wheels*,¹⁷ Ford's defined benefit occupational pension scheme, running its investments through a common investment fund, was charged VAT on its

investment management fees. Following the decision in the *Culverhouse* case¹⁸ where it was held that VAT is not payable on certain pooled funds, Ford considered that this also applied to certain pension funds, and reclaimed payment of the VAT. HMRC disagreed, and Ford (backed by other funds and the UK's National Association of Pension Funds) appealed to the UK first-tier Tax Chamber. The case was referred to the European Court of Justice for a preliminary decision, which is still awaited at the time of writing. The expectations are high that the ECJ will direct the UK tax authorities to remit tax in due course; it is understandable that the UK (and other) tax authorities would fight this case hard, given the state of the public finances, and the possible costs if they were to lose, but the strength of the pension fund industry's legal case is formidable. The outcome of the case will probably turn on whether the court has the appetite to deal a fresh financial blow to the member state treasuries, or bypass the law and treat it gently.

Corporation tax and withholding tax discriminations

For several decades, the EU Commission has been waging war against countries that impose discriminatory tax regimes on non-domestic pension plans. In *EC v Portugal*,¹⁹ Portuguese tax law imposed additional tax (compared with Portuguese pension funds) on income payable to non-resident pension funds. The European Commission issued proceedings against the Government of Portugal requiring compliance with cross-border non-discrimination. It was held by the European Court of Justice that the requirement by a member state to preserve fiscal coherence of the pension system is not an excuse for discrimination against non-resident pension systems. The imposition by a member state of prudential requirements and their detailed supervisions is no reason to discriminate against non-resident pension systems. Rules that make it less attractive to make an investment in a Portuguese company by a non-resident pension fund than a resident pension fund is illegal. A defence by a member state that a tax

discrimination is required to preserve fiscal coherence must be supported by showing a direct link to be established between the tax advantage concerned and the offsetting of that advantage by a particular tax levy. Reserving the benefit of a corporation tax exemption to pension funds resident in Portuguese territory alone is a breach of its obligations under the EU Treaty.

According to this decision, the ECJ accepted the arguments raised by the EC, under which, by granting a corporate income tax exemption on dividends received by Portuguese-resident pension funds and levying a 21.5 per cent withholding tax rate (20 per cent, at the time the procedure was brought) on dividends received by non-resident pension funds, the Portuguese legislation dissuaded non-resident pension funds from investing in Portuguese companies, and therefore Portugal failed to fulfil its obligations under Article 63 of TFEU and Article 40 of the EEA Agreement.

In practice, the ECJ decision has already been complied with by Portugal, as the 2012 State Budget proposal includes a provision whereby EU or EEA pension funds that comply with certain requirements will benefit from an exemption from corporate income tax, as applicable to Portuguese resident pension funds.

There are lessons here for the UK HMRC in its QROPS treatment of EU pension arrangements, which are clearly discriminatory. So far, HMRC has persuaded the Commission that its terms are acceptable, but it cannot be long before an aggrieved UK taxpayer takes it to the courts.

COLLECTIVE AGREEMENTS: ECJ DECISIONS ON DUTCH EMPLOYERS AND COLLECTIVE AGREEMENTS

Few of us think, for example, if we think about it at all, of a company pension scheme as being a business. It is a business-support tool, maybe, or a service to employees or any of a hundred other euphemisms, but not a 'business'. In fact, it is especially necessary for it not to be a business for tax purposes, otherwise tax would be levied on

the investment returns, as the UK HMRC still attempt to do from time to time.

However, in recent years, whether occupational pension schemes are a business has become increasingly important, at least in parts of mainland Europe. The reason is that 'second tier' or 'supplementary pension schemes' (often industry-wide pension funds and especially state-sponsored pension funds) on the grounds that they are 'undertakings' are subject to EU competition laws. Over the last 5 years, the European Court of Justice has considered cases where individuals have tried to prove that a pension scheme is indeed subject to the EU laws on competition. In some cases, this has been because some individuals have wished to be free to join a pension scheme other than their designated one; in other cases, it is because providers have wished to compete in the pension markets. There have been several decisions in the European Court of Justice in which the question was examined, of which two (*Albany* and *Federation Francaise*) one involving a French pension fund, and the other involving a Dutch one, are regarded as the leading cases.

Compulsion is now becoming an issue throughout Europe as social security pension schemes in many Member States come under demographic and financial pressures. If compulsory membership were outlawed for supplementary pension systems, it could put a big hole in welfare state arrangements in many Member States, not least at present the United Kingdom, where compulsory membership is being seriously considered as a replacement for part of the state system.

Before these two main cases, there had been some discussion of the problem in a couple of Dutch cases. In *Schijndel*,²⁰ Mr van Schijndel and Mr van Veen were physiotherapists in the Netherlands who were required by law to be members of an industry-wide physiotherapists pension scheme. They wished instead to become members of a personal pension scheme. The European Court avoided answering the question whether the competition rules apply to pension scheme membership; such a question is, it said, a question for the national court to answer. And,

said the Court, local courts are perfectly able to deal with these local issues without asking for a more general statement of law from the ECJ.

However, the main question remained: Is a pension scheme an 'undertaking' subject to the competition law – or is it 'social security' where the competition laws have no place? A few years later, in *Federation Francaise*²¹ the ECJ looked at the problem again. Under French law, certain agricultural industry-wide schemes that were funded (rather than pay-as-you-go) were given a monopoly of occupational pension provision in those industries. The complaint against compulsory membership came not from the members (or people who did not wish to become members) but from the insurance companies who were losing business as a consequence. The Court was asked:

'Whether a non-profit making organisation which manages an old-age insurance scheme intended to supplement a basic compulsory scheme established by the law as an optional scheme and operating according to the principle of capitalisation in keeping with the rules laid down by the authorities in particular with regard to conditions for membership, contributions and benefits, are to be regarded as an undertaking for the purposes of Article 85 et seq of the Treaty'.

The case is well worth a read for the defence that the French Government submitted: that it was really social security, that some people benefited while others lost, that such schemes only worked if they were compulsory and had a monopoly. In the end, said France, as they do so elegantly, it was hardly possible to consider the scheme competitive in nature; the European Court of Justice had already held in two earlier cases²² that organisations managing social security schemes were not undertakings in the sense covered by Article 85 and therefore not subject to the competition rules.

However, the ECJ was unpersuaded by elegant arguments. The court's response was firm. Although it is true that compulsory social security schemes, based on the principle of 'solidarity' (that is, where the working generation pays the pensions of the retired population) are not covered by the competition rules of the Treaty, there was

no solidarity here. First, membership of the scheme was optional. Second, it was a funded scheme, and thus there was some relationship between the contributions and the benefits. And its social objectives were no different to objectives pursued by comparable activities of insurance companies and company pension schemes. The fact that the scheme was non-profit-making was no argument that it did not engage in an economic activity. The bottom line was that the pension scheme, even though established by statute, was in breach of the competition rules.

Some pension monopolies are, however, considered acceptable. In *Albany International*, Albany contested the right of Dutch industry-wide pension schemes to require compulsory membership of their employees. It indicated that it could obtain higher pensions for its employees for its pensions more cheaply than outside the industry-wide scheme. If it succeeds, it will be able to opt-out of industry-wide schemes, which could no longer require all employers in an industry to participate.

The Advocate General gave an opinion in January 1999; he considered that Dutch industry-wide pension funds were undertakings for the purpose of EU competition rules – and that the industry-wide membership requirements were in breach of those rules, although they might be if they could not satisfy demand. He also indicated that they could exercise their current discretionary powers as to whether to exempt employers from the mandatory obligation. The ECJ did not in the end follow the opinion, and some Dutch industry-wide schemes are still able to continue to operate on the current mandatory basis; however, they need to demonstrate that they are underpinned by a form of collective agreement, rather than a statute.

In a similar later action, *Podesta*, the French AGIRC and ARRCO supplementary schemes provided survivors' benefits to men over 65 and women over 60 when widowed. Mr Podesta who was between 60 and 65 claimed that under the principles in the *Barber* case he was entitled to survivor's benefits. AGIRC and ARRCO argued that they were outside the scope of Article 119 because they are both mandatory

(which did not appear to help the Dutch schemes in the *Albany* case) and involved redistribution. If they are within Article 119, Mr Podesta would be entitled to equal treatment; if they are not, as social security schemes, they might come within the Equal Treatment in Social Security Directive (79/7), which allows unequal treatment where state pension age is unequal (although the French state pension scheme has equal retirement ages!). The French government announced in 1999 that AGIRC and ARRCO schemes are to be within the scope of the social security mobility directive Regulation 1408/71; this is probably intended to pre-empt the court and exclude the schemes from its jurisdiction. However, if AGIRC and ARRCO are indeed social security arrangements, then Regulation 1408/71 should always have applied to them, and some migrant workers would be entitled to higher benefits.

In *Albany*,²³ the ECJ did not in the end hold that employers can opt out of a mandatory supplementary scheme, but it did hold in *Podesta* that AGIRC and ARRCO were within the scope of Article 119, so that employers might be able to opt out of AGIRC and ARRCO. If so, significant numbers might opt out, which could impose pressure on the French unfunded arrangements and place them under stress. The chances of such a movement have been reduced in recent decisions such as *Pavlov* ((2000) 58 PBLR) where the Court repeated its views earlier expressed in *Albany*.

The conclusions of these not always consistent decisions of the European Court therefore seem to be:

- In principle, pension schemes, other than first-tier social security pension schemes, are regarded as 'undertakings', and therefore subject to the competition rules of the European Union, and in particular the rules against monopolies.
- In particular cases, the court may accept that a particular monopoly is reasonable having regard to special circumstances. These circumstances do not include, for example, inter-generational solidarity, or similarity to social security, but do include collective bargaining agreements.

For corporate pension schemes at present, all this may seem academic and pointless. However, all across Europe, there are pension schemes with monopolies, and if multinationals based in the United Kingdom thought there might be merit in a single scheme for all their employees but are put off by the compulsory membership of some continental schemes, the opportunity now for such a single scheme seems self-evident. And pension providers or asset managers (increasingly UK-based) who see funds slipping out of their hands into government-sponsored monopolies now have a chance to explore whether such monopolies can be broken. Thus, there are substantial opportunities for corporate pension funds and asset managers waiting out there. For a fairy tale ending, all it needs is for some little piggies to huff and puff and blow the walls down. And one day they will.

CROSS-BORDER MERGER AND ACQUISITIONS: RECENT UK REGULATOR DECISIONS

The EU pensions harmonisation programme was intended to enable improved business transactions across the European Union; so far, its contributions in this area seem to have been muted. Indeed, in some cases, it has made such transactions less attractive. In *Bonas UK*,²⁴ in July 2010, the UK Pensions Regulator issued a contribution notice in relation to the Bonas Group Pension Scheme for £5 million, the amount needed to take the scheme up to a position of solvency on the UK PPF basis. The Notice was imposed on the scheme employer's Belgian parent company, Michel Van De Wiele NV. VDW had acquired Bonas, a textile machinery business, in 1998. Even after restructuring, the business was loss making and the pension scheme in deficit. Eventually, in 2006, Bonas was put into administration and its assets and liabilities transferred to a new company within VDW's group on a pre-pack administration for £40000.

The Determinations Panel of the Pensions Regulator had decided not to impose a Contribution Notice on Mr Beauduin, the Chairman of VDW and Managing Director of

Bonas. The company sought a review of the powers of the Pensions Regulator in relation to the contributions notice, and the Regulator sought to overturn a decision of the Panel when it refused to issue a notice on an individual. It was held that the determinations panel of the Pensions Regulator is an emanation of the Regulator; accordingly, the Regulator is not empowered to appeal against its decisions, which would amount to an appeal against itself. The correct level of contributions to be imposed under a notice cannot exceed the amount that would have been payable had the parties not taken the steps complained of. In the event, the decision of the determinations panel of the Pensions Regulator was barred and the case remitted for a fresh consideration.

Although the appeal mainly concerned procedural points, the judgement revealed that the Upper Tribunal may well have a different take on the extent of the Regulator's powers. In particular, the Tribunal did not agree with the Regulator's approach of basing the amount of the contribution notice on the PPF deficit. Instead, the Tribunal said it should be linked to the amount by which VDW's actions actually reduced the S.75 debt Bonas would pay, which in this case is likely to be far less than the £5.089 million awarded. The case also demonstrates that securing a contribution notice or financial support direction in a Determinations Panel hearing is only the first hurdle. Bonas went into administration in 2006, and four and half years later no more money has yet been put into the pension scheme.

The Upper Tribunal clearly pushed back on a number of points, in particular as to the quantum of the contribution notice. It notably took a more stringent view of the legislation than the Determinations Panel. That Panel will now need to take on board its comments when reconsidering the case, which could result in a much lower figure being required by VDW, and of course there may be a further appeal. It must surely be time for the regulator to consider its policy in such cases, and make known the thinking behind its decision to pursue such cases, which do seem on the face of it to be unfair.

Other cross-border issues involve non-EU jurisdictions, but as a consequence of EU attempts at harmonisations. In *Nortel*,²⁵ Nortel Networks UK Limited maintained a pension plan (Nortel Networks UK Pension Plan) for its employees.

In January 2009, its US affiliate, Nortel Networks Inc, filed for Chapter 11 bankruptcy relief in the United States. At the same time, its ultimate parent, Nortel Networks Corporation, filed an application with the Ontario Superior Court of Justice under the Companies Creditors Arrangement Act (Canada) seeking similar relief from creditors, and the High Court in England placed 19 of Nortel's European affiliates the United Kingdom sponsor into administration.

In June 2009, and in response to a petition filed by the sponsor, the US Bankruptcy Court recognised the English insolvency proceeding as a foreign main proceeding under Chapter 15 of the US Bankruptcy Code.

Also in June 2009, the US debtors, the EMEA debtors and the Canadian debtors entered into an interim funding and settlement agreement by which the parties agreed to hold the net proceeds of any material asset sales in escrow pending resolution of certain cross-affiliate claims. The agreement provided that escrow would be maintained until the parties reached a consensual allocation or, if agreement could not be reached, the appropriate allocation would be determined in a single cross-jurisdictional forum. The agreement was approved by the US Bankruptcy Court.

In September 2009, the sponsor filed a proof of claim against the parents and affiliates for any unknown, unliquidated or unmatured claims.

The commencement of the UK insolvency proceedings triggered the UK Pension Plan into entering into a PPF assessment period. During the assessment period, the PPF worked with the UK trustees to determine the plan's funding position.

In September 2009, the Trustee and the PPF jointly filed proofs of claim against the parents and affiliates alleging that the plan was underfunded by around £3 billion, and that the Pensions Regulator sought certain of the US

parents and affiliates to provide financial support for the plan. The Pensions Regulator had determined that the plan was insufficiently resourced as at June 2008, and that there were sufficient grounds to issue Warning Notices and seek a Financial Support Direction against certain members of the Nortel Group, as companies connected with or associates of the sponsor.

In January 2010, the Pensions Regulator issued a warning notice, initiating an administrative proceeding, to US and non-US Nortel entities. The Warning Notice alleged that there was a shortfall in the plan as at June 2008, and that the Pensions Regulator believed it was reasonable to issue an FSD against the parent. The Warning Notice put a deadline of March 2010 for the parent to respond.

Following receipt of the Warning Notice, the US parent filed a motion with the US Bankruptcy Court seeking an order enforcing the automatic stay against the Trustee and the PPF with respect to the UK proceedings.

The US bankruptcy law provides for the automatic stay of bankruptcy proceedings under the 'police power' exception, which permits a governmental unit to commence or continue an action or proceeding that is in furtherance of its police and regulatory powers (under the US Bankruptcy Code).

Bankruptcy courts have previously held that the police power exception extends to actions taken by the Pension Benefit Guaranty Corporation, the equivalent agency charged with protecting pension benefits in private sector defined pension plans in the United States.

The issue before the bankruptcy court in Delaware was whether the police power exception extended to proceedings initiated by the UK Pensions Regulator. Although another Delaware bankruptcy court had approved a settlement stemming from regulatory actions taken post-petition by the Pensions Regulator in *In re Sea Containers*, 2008 WL 4296562 (Bankr D Del 19 September 2008), the *Nortel* Bankruptcy Court found that the police power exception did not extend to actions taken by the Pensions Regulator. The District Court affirmed the Bankruptcy Court's decision, and the

Regulator and trustees appealed to the Court of Appeals.

It was held that the stay imposed by Section 362 of the US Bankruptcy Code is very broad, and any acts to 'assess' a claim that arose before the Petition Date are prohibited. Although the exercise of a governmental unit's police or regulatory power is exempt from the automatic stay under Section 362(b)(4), the exception does not apply where the applicant is not a governmental unit. Although the PPF is defined as a statutory body, it exercises the rights and powers of the Trustee during an assessment period, and therefore stands in the shoes of a private party in such circumstances. The US law narrowly construes the police power exception, and the actions of the PPF and the Trustee are barred by an automatic stay.

Generally speaking, bankruptcy courts apply one of two objective tests when determining whether an action falls within the police power exception – the 'pecuniary purpose' test or the 'public policy' test. Under the pecuniary purpose test, the question is whether the governmental action or proceeding relates primarily to the protection of the government's pecuniary or financial interest in the debtor's property, or to matters of public safety or welfare. The purpose of UK proceedings is to address alleged shortfalls in private pension plans. This purpose does not address matters of public safety or welfare, and therefore UK proceedings do not satisfy the pecuniary purpose test.

The UK proceedings also fail the public policy test. The public policy test examines whether the governmental action at issue is taken in furtherance of a matter of public policy, or whether it is intended to adjudicate private rights. The Pensions Regulator does not seek to protect the safety or welfare of the public, but instead it seeks to obtain financial support for the benefit of private parties. Any amounts received through the UK Proceedings do not generally benefit the public, but instead reduce the debt owing by a sponsor to a trustee. The UK proceedings do not satisfy the public policy test. The decision on September 2008 in *In re Sea Containers* is not a precedent. That case involved claims made by the

Pensions Regulator against a US debtor for obligations owing under an affiliate's UK pension plan. An FSD was issued post-petition against a single US debtor. The debtor did not file a motion to invoke or lift the automatic stay, and one of the two US creditor's committees appointed in the case encouraged an FSD to be issued so that the pension plan trustee could rely on it when pursuing claims in the case. Following the issuance of the FSD, a settlement was reached that granted the pensions trustee an allowed claim in the bankruptcy case. The settlement agreement was filed with the bankruptcy court for approval. The bankruptcy court approved the settlement agreement over the objection of certain parties, including the second creditor's committee who argued that the FSD proceeding violated the automatic stay. The bankruptcy court ruled that the FSD "should not be ignored as invalid" because it "provided guidance as to the ... pertinent considerations in valuing" the claims. Further, the bankruptcy court also considered the fact that the UK Determinations Panel did not view itself as being subject to the automatic stay, and no party sought an order from the bankruptcy court enforcing the automatic stay.

Sea Containers only involved an FSD proceeding, and not an attempt to secure financial support through an enforceable debt. Where a case involves the allocation of billions of dollars of proceeds from post-petition asset sales, and US companies, Canadian companies and the European and Middle East companies enter into an agreement under which they agree that the proceeds of any sales would be held in escrow and the parties would negotiate in good faith to determine how to properly allocate the proceeds, the court will be reluctant to allow an administrative body with a single constituency, such as the Pensions Regulator in the United Kingdom to decide various issues that overlap with the matters being negotiated by the parties under the agreement. Such interference would be unfair to the US companies, and Canadian companies would be contrary to the negotiations among the parties and the spirit of the agreement.

In the event, the application by the PPF and the UK plan trustees was rejected.

The *Sea Containers* case has given false and unwarranted confidence to the UK authorities that they had the power to assert prior claims over other creditors in an international insolvency. That belief has been sharply knocked back, and rightly so. The UK regulators faced a dilemma; there is a big deficit to be picked up, it will be expensive to resolve, the levy will need to be increased over time and politically it looks unappetising. It is sensible in such cases to test the boundaries of the law.

On the other hand, it is discourteous for overseas courts to try to overturn their jurisdiction, apply indigenous law overseas, disrupt a very complex agreement covering multiple jurisdictions and claims which had been painfully and expensively come to.

The case involves profound issues of public policy issue; it is disappointing that the regulatory bodies did not issue a discussion document explaining their policy in expending public funds in expensive litigation, which challenged international judicial comity and good insolvency practice and discussing with transparency their considerable dilemmas.

The lack of transparency and considerable legal expenditure indicates a certain self-indulgence and lack of control within the organisations, which will come as a disappointment at a time of austerity. It is expected that the new regime recently installed in the Pensions Regulator may find it expedient in future to appoint a General Counsel (preferably part-time, semi-retired and wise with age) who might prevail upon his board to act with greater circumspection and economy in future adventures of this kind.

REGULATION: THE DEVELOPING INFLUENCE OF EIOPA AND PROPOSED FUNDING CHANGES IN SOLVENCY II AND IORPS II

The European Union has been involved with pensions regulation now for many years. In addition to the IORPS directive, it also established some years ago a consultative group (CEIOPS – the Committee of European

Insurance and Occupational Pensions Supervisors) designed to advise it on future regulation and the effectiveness of the existing rules.

The European Commission following the 2007/2008 financial crisis considered that there needs to be further regulation of EU occupational pension plans; it has therefore reviewed the present IORP Directive, abolished CEIOPS and introduced a new regulator with material powers, EIOPA.

The EIOPA was established following reforms to the structure of supervision of the financial sector generally (that is, not just occupational pensions) in the European Union. The reform was initiated by the European Commission, following the recommendations of a Committee of Wise Men and supported by the European Council and Parliament. The European Parliament had been pressing for some time for a move towards more integrated European supervision in order to ensure a level playing field for all actors at the level of the European Union and to reflect the increasing integration of financial markets in the Union. EIOPA is part of a European System of Financial Supervisors that comprises three European Supervisory Authorities, one for the banking sector, one for the securities sector and one for the insurance and occupational pensions sector, as well as the European Systemic Risk Board. EIOPA's main goals are stated to be:

- Better protecting consumers, rebuilding trust in the financial system.
- Ensuring a high, effective and consistent level of regulation and supervision taking account of the varying interests of all Member States and the different nature of financial institutions.
- Greater harmonisation and coherent application of rules for financial institutions and markets across the European Union.
- Strengthening oversight of cross-border groups.
- Promote coordinated European Union supervisory response.

EIOPA's core responsibilities are to support the stability of the financial system, transparency of markets and financial products, as well as the

protection of policyholders, pension scheme members and beneficiaries. EIOPA is commissioned to monitor and identify trends, potential risks and vulnerabilities stemming from the micro-prudential level, across borders and across sectors. EIOPA is an independent advisory body to the European Parliament, the Council of the European Union and the European Commission. To account for the specific conditions in national markets and nature of financial institutions, the European System of Financial Supervision is an integrated network of national and European supervisory authorities that provides the necessary links between the macro- and micro-prudential levels, leaving day-to-day supervision to the national level. EIOPA is governed by its Board of Supervisors, which integrates the relevant national authorities in the field of insurance and occupational pensions in each Member State. The European Union's national supervisory authorities are a source of expertise and information about insurance and occupational pensions matters. For market practitioners, the governance of EIOPA is a matter of some concern; it has the potential to act as a cartel with other regulators and the checks and balances are somewhat opaque.

In the EU Commission proposal for IORP 2, it suggested that there needs to be supervision expanded to all member states, to encourage cross-border activity and to introduce risk-based supervision. In April 2011, the Commission sought advice from EIOPA on suitable methods. EIOPA responded in February 2012 with a proposal designed to avoid the application of Solvency II (the insurance-related requirements) known as the 'holistic balance sheet' as a possible solution to the demand for increased harmonisation.

A holistic balance sheet implicitly accepts that there are material differences between pension funds and insurance companies. Both the Commission and EIOPA have accepted that Solvency II may not be appropriate when applied to corporate pension plans.²⁶

There is a broad acceptance among those in the pensions industry (though not in the insurance industry) that pension schemes differ

from conventional financial obligations and would benefit from a bespoke regulatory framework, and which respects individual aspects of pension fund plans that differ markedly in different jurisdictions.

The EIOPA's proposal of a holistic balance sheet approach while more sensible and cost-effective than Solvency II nonetheless poses problems of its own. The calculation of an HBS may be complicated and expensive to prepare and involve the application of assumptions, which themselves lead to unintended consequences.

The difficulty is made worse by a lack of consensus on what the function of regulation might be. For many years, defined benefit schemes were intended to offer expectations rather than guarantees, as the price of guarantees was considered too expensive. In modern terms, they were aspirational pensions. Insurance policies on the other hand were thought (though were not) required to offer guarantees, although they are required to policyholders' reasonable expectations (at least in the United Kingdom). Regulators are expected to know better than the sponsor what are reasonable assumptions to make on contributions, investments, employer covenants and funding solvency and communicate the risks involved to members and others involved. In practice, regulators find this all but impossible to achieve; nonetheless, regulators continue to assess in those jurisdictions where it is appropriate the solvency, risk exposures, management and transparency of plans.

Pensions are hard to regulate without unintended consequences because they vary in nature so widely. The legal obligations involved also vary; DC plans give no expectations on returns. Until recently, DB plans gave no guarantees on benefit levels, nor did the plans have a right to call for payment from plan sponsors, nor acquire any senior debt quality on sponsor insolvency (for obvious business reasons).

The EIOPA HBS attempts to ensure in theory at least that the pension plan's terms are reflected in the corporate balance sheet in a way that recognises the strength or otherwise of the sponsor covenant (or other support) in the pension schemes accounts better than the current

asset/liability models do. HBS is supposed to offer a number of benefits, including:

- Incorporation of all relevant assets (not just those in the plan) in assessing the solvency of pension schemes.
- Improving comparison between different pension schemes of a similar nature.
- Increased discipline and professional risk management.
- Improved transparency.

There are, however, possible drawbacks, including:

- The valuation of contingent balance sheet items may prove to be questionable, involving complex financial techniques.
- The cost of implementation might be disproportionately expensive for smaller pension plans, an existing problem for existing plans.
- The creation of a false sense of security for members.
- The difficulty of incorporating valuations of sponsor covenants and contingent assets on a consistent basis.
- The discrimination against alternative pension systems, such as book reserve and unfunded systems.

EIOPA is presently preparing what is the buzzword of financial regulation, that is, a quantitative impact study for the HBS and is far from settled whether it will prove the basis of an alternative to Solvency II.

EQUAL TREATMENT

Over the years, equal treatment has affected pensions in the European Union and the United Kingdom in particular in many ways; the continued acquisition of occupational pension rights during maternity leave, equalisation of retirement and occupational pension ages, equalisation of part-time membership of pension schemes, access for older women to non-contributory state benefits, the preservation of pension rights acquired in one member state scheme if a worker moves to another member states and other benefits.

Issues still remain outstanding, including, for example, the much vexing question of whether equal treatment must be applied in detail in the United Kingdom in relation to its discriminatory state scheme.²⁷ The matter had largely disappeared from view for 20 years following the *Barber*²⁸ decision in 1990 until resurrected like the resurrection of some movie vampire. The UK pensions industry is presently preparing quantities of garlic and stakes to hasten the demise, but they may be ineffective.

Meanwhile, equality issues continue to appear before the European Court of Justice, despite the feeling that the *Barber* case and its immediate cousins had disposed of the issue 20 years before. Two in particular (apart from age discrimination, see below) have crossed the horizon, namely, *Romer* and *Test-Achats*.

Romer v Hamburg

One reflected the change in the last 20 years in social living arrangements. In *Romer*,²⁹ Mr Jürgen Römer worked for Hamburg Council from 1950 until 1990, when he retired on the grounds of incapacity. From 1969, he lived continuously with his companion, Mr U, with whom he entered into a civil partnership in accordance with the German law on registered life partnerships. When calculating his retirement pension, in 2001, the City of Hamburg refused to apply the more favourable tax category applicable to married pensioners. It argued that only married, not permanently separated, pensioners and those entitled to claim child benefit or equivalent benefit, are entitled to the more favourable tax category. Mr Römer appealed to the Hamburg Labour Court, which referred the case for a preliminary judgment to the European Court of Justice. It was held that the provision of lower supplementary retirement pension for registered same-sex partners compared with married partners constitutes unequal treatment. Registered same-sex partners must be treated equally to married partners, and such pension fall under the meaning of 'pay' within the EU Employment Framework Directive (Dir 2000/78/EC). In the event, the case was referred back to the Hamburg Labour Court.

The key question was whether or not registered partners 'have [legal] duties towards each other, to support and care for one another and to contribute adequately to the common needs of the partnership by their work and from their property, as is the case between spouses'. It was not necessary to show that national law generally and comprehensively treats registered partnership as legally equivalent to marriage. The *Römer* judgment is likely to have repercussions in a number of EU Member States, including France, the Czech Republic and Slovenia (but not the United Kingdom) where registered same-sex partners have mutual support obligations, but appear to be excluded from survivor's pensions.

Test-Achats

Similarly, the impact of equalisation on annuities is yet to be settled in full. In *Test-Achats*,³⁰ a Belgian consumer organisation and two private individuals brought an action to declare unlawful a domestic law that transposes the Gender Directive (2004/113/EC) into Belgium law. The Directive requires all member states to apply the principle of equal treatment between men and women in the access to and the supply of goods and services, including insurance. Article 5(2), however, enables member states to allow 'proportionate differences' in insurance premium and benefits where the use of sex is a 'determining factor' in the assessment of risk 'based on relevant and accurate actuarial and statistical data', provided member states ensure that such data are 'compiled, published and regularly updated'. All member states who implemented the Directive, including the United Kingdom, have made use of the opt-out in Article 5(2) in respect of one or more types of insurance. Belgium derogated from the Directive in respect of life insurance. The application, however, sought a declaration that the national law implementing the derogation was unlawful.

It was held that Article 5(2) should be considered invalid as from 21 December 2012, 5 years after the Directive came into force on the grounds that the Charter of Fundamental Rights of the European Union states that any

discrimination based on sex is prohibited and that equality between men and women must be ensured in all areas. While the Gender Directive applied this principle of equality to the supply of goods and services and Recital 18 expressly states that, in order to guarantee equal treatment between men and women, the use of sex as an actuarial factor should not result in differences in premiums and benefits.

As the Directive recognised that the use of actuarial factors related to sex was widespread in the provision of insurance at the time the Directive was adopted, it was permissible for the EU legislature to implement the principle of equality for men and women – more specifically, the application of the rule of unisex premiums and benefits – gradually, with appropriate transitional periods. Although the Directive also provided for member states to review their decision to make use of the opt-out by 21 December 2012, it was silent as to how long they could continue to allow insurers to use gender as a factor.

Accordingly, there is a risk that EU law may permit the derogation from the equal treatment of men and women, provided for in Article 5(2) of [the Directive], to persist indefinitely. Such a provision, which enables the Member States in question to maintain without temporal limitation an exemption from the rule of unisex premiums and benefits, works against the achievement of the objective of equal treatment between men and women, which is the purpose of [the Directive] and is incompatible with [the Charter]. That provision must therefore be considered to be invalid upon the expiry of an appropriate transitional period. That period ends on 21 December 2012.

It was held in the event that Article 5(2) of Council Directive 2004/113/EC of 13 December 2004 implementing the principle of equal treatment between men and women in the access to and supply of goods and services is invalid with effect from 21 December 2012. This decision did not come as a great surprise to watchers of EU decisions on equal treatment, but it might have been sensible for the judiciary to be slightly less gung-ho in encouraging providers

of services to avoid the laws of nature, as the unintended consequences may be less than welcome.

The exemption in the Gender Directive which allowed insurers to take sex into account when calculating premium and benefits offends against the principle of equal treatment between men and women (and which is invalid with effect from 21 December 2012) had a purpose and it clear that that purpose is now unacceptable. The decision has only incidental application to the provision of private sector pension scheme benefits. However, the logic underpinning the case would seem to apply equally to the Pensions Directive that categorically permits use of sex-specific actuarial factors in private sector pension schemes. There may be grounds to distinguish the use of sex-specific actuarial factors in pension schemes from their use in insurance provision, but it is unlikely that the ECJ would be attracted to any such arguments.

In practice, few pension funds that offer internal annuities are likely to be much affected; the internal calculations will still need to reflect experience and real life; the purchase of external annuities, however, may need further consideration. It is also not finally settled that the case actually applies to uninsured pension arrangements. Pension schemes are not in business, and they do not provide services as defined in EU legislation. However, the distinction is unlikely nowadays to be much appreciated by the courts.

It is not known at present whether there will be or need to be amendments to UK legislation; the UK government is unusually sensitive to being sued for failure to implement EU law, which may happen if individuals who suffer detriment bring their claim against the national government for failing to implement EU law correctly.

The European Commission has now had second thoughts on the application of this decision on the operation of occupational pension funds, and has taken upon itself the conclusion that it hardly applies – until the next case comes along.³¹

Insurance and occupational pensions

- 21 Some insurance products, such as annuities, contribute to retirement income. The Directive however only covers insurance and pensions which are private, voluntary and separate from the employment relationship, employment and occupation being explicitly excluded from its scope Equal treatment of women and men in relation to occupational pensions is covered by Directive 2006/54/EC of the European Parliament and of the Council of 5 July 2006 on the implementation of the principle of equal opportunities and equal treatment of men and women in matters of employment and occupation (recast).
- 22 Some occupational pension schemes provide for the payment of a benefit under a specific form, such as annuities. Where that is the case, the scheme in question will fall under Directive 2006/54/EC even if it relies on an insurer to pay out the benefit. On the contrary, if the individual employee has to conclude an insurance contract directly with the insurer without involvement of the employer, for example to convert a lump sum into an annuity, the situation will fall within the scope of the Directive. Article 8(1) (c) of Directive 2006/54/EC specifically excludes from its scope insurance contracts concluded by workers and to which the employer is not a party.
- 23 Article 9(1) (h) of Directive 2006/54/EC allows for the setting of different levels of benefits between men and women when justified by actuarial calculation factors. The Commission considers that the Test-Achats ruling has no legal implications for this provision, which applies in the different and clearly separable context of occupational pensions and which is also drafted in a very different way from Article 5(2) of the Directive. Indeed, under Article 9(1) (h) of Directive 2006/54/EC, the setting of different benefits for men and women is not considered discriminatory when justified by actuarial data.

In other words, occupational pension schemes can continue, if, they are careful, to discriminate, provided it is done in accordance with the current legislation.

VESTING AND PORTABILITY

The right of workers moving within the European Union to have their pension rights

preserved has been assured for many years in relation to their state pension rights.³² Extending those rights to private pensions has proved somewhat problematic. For some time, there has been a little noticed EU directive in relation to people moving their supplementary pension rights within the European Union.³³ The principal provisions include:

- A person who leaves a scheme because he moves to another Member State must not be treated differently to a person who leaves the scheme but remains in the Member State, as far as his/her vested rights are concerned. 'Vested pension rights' means any entitlement to benefits obtained after fulfilment of the conditions required by the rules of a supplementary pension scheme and where applicable by national legislation.
- Member States should take the necessary measures to ensure that benefits under supplementary pension schemes are paid to members and former members thereof, as well as others holding entitlement under such schemes in all Member States, given that all restrictions on the free movement of payments and capital are prohibited under Article 56 EC of the Treaty.

In fact, the Directive does not cover what is often called 'portability' of supplementary pensions, that is, the possibility of acquiring pension rights (even for shorter periods of employment than that required by the scheme minimum 'vesting period' or at the beginning of one's career) and keeping pension entitlements by transferring them to a new scheme in the event of professional mobility. A lack of portability could in theory have a serious effect on worker mobility.

There has been much disagreement among the member states about whether there should be genuine portability, but so far most initiatives have stalled.³⁴ There have been several subsequent attempts.³⁵

Cross-border pension schemes

One of the principal objectives of EU intervention into the pension system was to help dismantle barriers to cross-border activity. One

way of doing that was to encourage cross-border provision for pensions. Although there are EU rules requiring member states to dismantle their barriers to such arrangements (and have been operating in relation to state pensions for several decades) and rules came into force on 30 December 2005 for occupational pension schemes operating cross-border in another EU member state, in practice almost all member states continue to impose barriers of some description (mostly fiscal). And even those that purport to comply are in breach of the timetables imposed.

The EU requirements include that a cross-border scheme to be recognised as such, and given the usual freedoms must be:³⁶

- fully funded;
- authorised and approved by the local regulator;
- subjected to full actuarial valuations annually; and
- compliant with the social and labour laws of the other relevant member state.

They set out the conditions that an occupational pension scheme located in a member state must meet before it can begin to operate as a cross-border scheme.

The deadline for member states to comply with IORP was 22 September 2005. Only 9 out of 25 member states met this deadline (the United Kingdom not being one of them).

Under the IORP Directive, occupational pension schemes established in one EU member state can engage in ‘cross-border activity’, that is, accept contributions from a European employer (an employer under a cross-border scheme) and scheme members in other member states.

This is subject to certain conditions, including prior authorisation and approval by the relevant competent authority (in the United Kingdom, for example, it is the Pensions Regulator). In practice, a multinational operating in a number of member states through subsidiary companies might wish to consolidate its pension arrangements in one member state or an employer in one member state might have commercial reasons for locating its pension

scheme in another member state, to share risks and costs.³⁷

In the United Kingdom, for example, trustees of a pension plan are liable to a civil penalty on the following grounds:

- if they receive contributions from a European employer;
- in the absence of approval and authorisation as a cross-border scheme; and
- without relevant notifications from the local regulator (see, for example, in UK Pensions Act 2004 s287).

A cross-border scheme is one that has ‘European members’ or ‘European survivors’ (the latter meaning the survivors of European members who are entitled to benefits or have a right to future benefits under the scheme).

European members are (broadly) employees (or self-employed persons):

- who are ‘qualifying persons’ – that is, those whose contractual place of work is (or was) sufficiently located in another EEA member state (other than the United Kingdom) ‘so that his relationship with his employer is subject to the social and labour law relevant to the field of occupational pensions’;
- who are not ‘seconded workers’ – see panel; and
- in respect of whom contributions were made to the scheme by a European employer (that is, the entity that employs the qualifying persons).

The rules are not free of ambiguity, and it is generally agreed that:

- a scheme with active members outside, for example, the United Kingdom and only in other countries outside the European Union – for example, the United States, Singapore, Japan or Australia – does not qualify as a cross-border scheme; and
- active members in, for example, the United Kingdom (for example, Scotland or Northern Ireland) or in parts of the British Isles not within the European Union (for example, the Channel Islands or the Isle of Man) do not count

(although for historical reasons employees in the Republic of Ireland do).

<i>EU countries</i>	<i>Non-EU countries but count as EU for cross-border purposes</i>	<i>Examples of non-EU countries</i>
Austria	Iceland	Jersey
Belgium	Liechtenstein*	Guernsey
Bulgaria	Norway	Isle of Man
Cyprus		Canada
Czech Republic		Australia
Denmark		Singapore
Estonia		Switzerland
Finland		The United States
France		Japan
Germany		Hong Kong
Greece		
Hungary		
Ireland		
Italy		
Latvia		
Lithuania		
Luxembourg		
Malta		
Poland		
Portugal		
Romania		
Slovakia		
Slovenia		
Spain		
Sweden		
The Netherlands		
The United Kingdom		

**Added from 23 April 2007.*

Having deferred members or pensioners who, having been employed in the United Kingdom, are now outside the United Kingdom and in another EU member state should not of itself make the scheme a cross-border scheme if they are no longer employed by a scheme employer (even if they are employed by an associated employer).

The position is less clear if a deferred member or pensioner was in fact working in the other member state for a scheme employer. It is possible that they could (even though no longer active members) fall within the definition of a qualifying person. There is nothing in the legislation that expressly requires a link between the employment and qualifying for benefits under the scheme. Instead, the link is whether contributions are paid to the scheme by the employer 'in respect of' that member.

In practice, it seems odd to categorise the employment of a deferred member as potentially

qualifying a scheme as cross-border. It will often be unlikely that a European employer is making contributions to the scheme in respect of a deferred member or pensioner (even general deficit contributions should be difficult to categorise in this way).

TPR's guidance only says that: 'Trustees and employers should be mindful of the position of all members, including deferred members and pensioners, when considering whether their scheme should be seeking authorisation and approval'.

To be a cross-border scheme (and have a European employer), the employer must be making contributions to the scheme in respect of the non-UK employees (in practice, this is unlikely unless the non-UK employees are active members of the scheme). Seconded workers (see panel) are to be disregarded in determining whether an employer is a European employer. A scheme does not carry on cross-border activity if its only active members employed in another member state are seconded workers. This means that fewer schemes fall within the cross-border definition.

Given the potential onerous requirements, should a scheme become cross-border (see below), some schemes have included an 'auto-eject' rule – that is, an express rule that a member will automatically cease to be an active member if he starts to work in an EEA state (unless the secondment provisions apply).

This helps reduce the risk of an inadvertent contravention if there is a change in employment location of a member. It relies (to a degree) on the member becoming a deferred pensioner on his relocation and so not becoming a European member (because the employer ceases to contribute in respect of him).

There is no restriction of the cross-border requirements to DB tax-registered schemes. A cross-border scheme can be:

- DC;
- a scheme without tax registration; or
- a UK s615 scheme (established only for employees outside the United Kingdom).

Seconded workers do not normally count as a European member. The UK Pensions Regulator

has published a guide to help decide whether or not a scheme falls within the cross-border provisions. In the United Kingdom, if employees are sent by a UK employer to work overseas for a period in another EU member state, and at the end of that period they intend to resume work for that employer in the United Kingdom or intend to retire, then:

- they were sent to the other EU member state for a limited period; or
- they were sent for the purpose of providing services on behalf of the UK employer.
- If they intended at the end of that period either to return to the United Kingdom to work for the same employer or to retire,

then they are counted as seconded employees. The characteristics of a secondment are:

- the employee being sent to work overseas from the United Kingdom;
- the employee providing services on behalf of the UK employer;
- the limited period; and
- the expectation either to return to the United Kingdom or to retire (in the United Kingdom or otherwise) at the end of that period.

TPR's guidance points out that the cross-border requirements will cease to apply if all the liabilities for any European members (or survivors) are bought out in full or transferred to another arrangement.

When there is cross-border activity with another member state, the European Pensions Directive requires that an occupational pension scheme 'shall at all times be fully funded'.

A local plan may need authorisation and approval by the domestic regulator. The determining factors are the main administration of the scheme and the place of work of the member. For example, if the scheme's main administration is in the United Kingdom and has members in another member state, it could still require authorisation and approval, even if the employer were in a third, non-EU country. Unlike a domestic scheme, a cross-border scheme

is not permitted to rectify its underfunding through the use of a recovery plan, although the cross-border regulations envisage a very limited recovery period in certain circumstances: schemes entering into cross-border activity will have to obtain annual valuations and to make up within 24 months of the effective date of a deficit valuation any shortfall identified in it on the statutory funding objective basis (Pensions Act 2004 s222). If the scheme's main administration was in a non-EU country, it would not require authorisation and approval, even if it had members in both the United Kingdom and another EU member state (it would be a foreign scheme).

Some regulators consider that the European Pensions Directive requires an entire cross-border scheme (including the UK element) to be fully funded; others consider that it simply applies only to the cross-border element of a scheme. In the United Kingdom, the regulations apply the fully funded requirement to the entire scheme. This means that a scheme with just one (non-UK) scheme member employed at a branch in another member state would be brought within the cross-border provisions and have to be fully funded at all times. In practice, this seems to have deterred schemes from taking advantage of the cross-border provisions.

A cross-border scheme must comply with the 'social and labour laws' of the other relevant member state. This is interpreted by different member states in very different ways. The UK application of this rule is clearly flawed.

The Directive requires each regulator to be satisfied about the 'good reputation and professional qualifications or experience of the persons running the institution'.

Legitimate expectation and forfeiture

In *Klein v Austria*,³⁸ Mr Klein was a Viennese lawyer struck off for embezzlement. He had been a member of the lawyers' pension scheme, which forfeited his pension consequent on his being struck off, on the grounds that he had to be in practice at the time his retirement age was achieved. Following unsuccessful claims to several tribunals including the Administrative Court and

the Constitutional Court, he applied to the European Court of Human Rights. It was held that where there is compulsory affiliation to an old-age pension scheme based on the equally compulsory membership of a professional organisation during the exercise of a profession, it may give rise to the legitimate expectation to receive pension benefits at the point of retirement and constitutes a possession within the meaning of Article 1 of Protocol No 1 of the European Convention on Human Rights. It was held that there had been a violation of the Treaty, but that the claim should be reduced by the amount of set off paid by the pension scheme to clients of the complainant whose funds he had embezzled. That this case had had to travel so far suggests a legal profession in Austria and a court system that is somewhat merciless and disproportionate in its punishments. Similar forfeiture penalties were imposed by UK local government until restricted by the Pensions Acts, but those were not cases where the individual had made his own contributions.

It is understandable that there should be a set-off for sums remitted to persons the claimant had defrauded, but the idea that there should be a financial penalty without an order of the court suggests that the Austrian mindset remains somewhat feudal. This decision will not change the mindset, but it should have a small influence.

Cross-border preservation and vesting

In *Casteels*,³⁹ Mr Casteels worked for British Airways from 1974 in different member states of the European Union. He acquired rights in the supplementary (occupational) pension scheme in each member state; his service under German law in the German pension scheme, however, only vested fully after 10 years of service. Mr Casteels complained through the Belgian Labour Court that his pension rights had been adversely affected and that the provisions of the European Union Treaty Article 48 had direct effect and that the action of British Airways amounted to discrimination. The Belgian court referred the

questions to the European Court of Justice for a preliminary ruling. It was held that Article 48 TFEU does not have any direct effect capable of being relied on by an individual against his private sector employer in a dispute before national courts.

Article 45 TFEU must be interpreted as precluding, in the context of the mandatory application of a collective labour agreement:

- for the determination of the period for the acquisition of definitive entitlements to supplementary pension benefits in a Member State, the non-inclusion of the years of service completed by a worker for the same employer in establishments of that employer situated in different Member States and pursuant to the same coordinating contract of employment;
- a worker who has been transferred from an establishment of his employer in one Member State to an establishment of the same employer in another Member State from being regarded as having left the employer of his own free will.

The case was referred back to the Brussels Employment Tribunal. One wonders what the HR department at British Airways were doing, trying to argue about the pension rights of one of their loyal employees, regardless of the law. Maybe there was a greater principle that was causing concern. It is clear that the claimant was morally entitled to pension rights for his period of service and that the years of service should not have to rely on arbitrary vesting provisions in each member state in which he worked. Some advisers have been suggesting work-arounds following the decision, but the impact of employee relations of such restrictions on the benefits of mobile employees will be material.

More interestingly, from a legal viewpoint, the decisions seems to make almost redundant the need for a European Directive on cross-border vesting drafts for which have been circulating the Commission and Parliament for several years. We now have cumulative service imposed by the

court, and only the most critical of the European dream will consider this to be an unfair intervention into the employer's freedom of contract.

AGE DISCRIMINATION

Age discrimination has been largely illegal within the European Union for many years;⁴⁰ in *Fuchs*⁴¹ Mr Fuchs was a state prosecutor who when he reached the normal retirement age of 65 was retained for a further year, but was not thereafter kept on. He complained to the administrative court in Frankfurt on the grounds that the retirement age fixed in his contract of employment breached the age discrimination requirements of EU law. The employer, a state organisation, pleaded that such discrimination was permitted under German law. The court referred the matter for a preliminary ruling to the European Court of Justice.

It was held that Council Directive 2000/78/EC of 27 November 2000 establishing a general framework for equal treatment in employment and occupation does not preclude a law, such as the Law on the civil service of the county of Hessen (*Hessisches Beamtengesetz*), as amended by the Law of 14 December 2009, which provides for the compulsory retirement of permanent civil servants at the age of 65, while allowing them to continue to work, if it is in the interests of the service that they should do so, until the maximum age of 68, provided that that law has the aim of establishing a balanced age structure in order to encourage the recruitment and promotion of young people, to improve personnel management and thereby to prevent possible disputes concerning employees' fitness to work beyond a certain age, and that it allows that aim to be achieved by appropriate and necessary means.

In order for it to be demonstrated that the measure concerned is appropriate and necessary, the measure must not appear unreasonable in the light of the aim pursued and must be supported by evidence the probative value of which it is for the national court to assess.

A law such as the Law on the civil service of the county of Hessen, which provides for the

compulsory retirement of prosecutors when they reach the age of 65, does not lack coherence merely because it allows them to work until the age of 68 in certain cases or also contains provisions intended to restrict retirement before the age of 65, and other legislation of the Member State concerned provides for certain – particularly elected – civil servants to remain in post beyond that age and also the gradual raising of the retirement age from 65 to 67 years. The case was referred back to the Frankfurt Administrative Court.

This is a curious outcome to an age-discrimination claim, which on the face of it seems incontrovertible. But non-UK jurisdictions seem to take a more cavalier (and some would say pragmatic) approach to EU law and this case exemplifies it. The ECJ is increasingly cognizant of the political limits of its jurisdiction and reluctant to impose excessive burdens on economies that are just about keeping their souls attached to their bodies.

UK employers may now seek to retain a formal retirement age, but it needs to be accompanied by a decent pension. The decision itself adds to the list of legitimate aims that might be used to justify compulsory retirement, with most firms aiming to avoid legal disputes with older employees over whether they are fit to continue. It is probably best not to delve too deeply into the legal arguments expressed in *Fuchs*; they are rather thin and other judges may take a different view in future. The decision may also have slightly more limited application than at first appears. First, it deals with the public sector. Second, it deals with a sector that has good pensions. Third, it refers specifically to idiosyncratic German legislation. Whether it applies with such certainty to UK private sector employers with modest pension systems is still unclear. However, regardless of its scope, it is clearly a leading decision and will be relied on widely in future disputes, especially as, on the face of it, it all but renders nugatory the age-discrimination legislation.

However, the case that really caused a few eyebrows to rise was that which suggests that airline pilots should not really have a retirement

age. In *Prigge*,⁴² Mr Prigge was an airline pilot employed by Lufthansa, the German airline. His employment contract was terminated when he was 60 under a collective agreement relating to pilots. He complained to the local labour court that the age limit was not necessary for the objective of air safety, and even if it did that air safety was not among the objectives permitted by the European Directive on Equal Treatment. It was held that the objective of air safety is not necessarily objectively and reasonably justified by imposing a retirement age of 60 on air pilots. It was held that the imposition of a retirement age of 60 by a collective agreement is not justified by a requirement to meet public safety when general law imposes an age of 65.

The decision is not quite as wild as reported elsewhere in the press; it is limited to capping a retirement age to such an age as set down by general law. The prospect of centenarian air pilots is not yet upon us (although it might be) unless there can be proper evidence that the risks are too high. Job-specific retirement ages are still on the menu where objectively justifiable – and the fact that the court has elsewhere accepted the lump-of-labour fallacy suggests that total liberation in relation to age discrimination is still some time away.

LEGISLATIVE PREFERENCES FOR AND CONSTRAINTS ON ALTERNATIVE FORMS OF PROVISION

One major concern is that occupational or corporate pension plans are established in different ways in different jurisdictions. In the United Kingdom, for example, with some rare exceptions it is possible in practice to establish only pure DC or pure DB plans; anything other than a pure DC is regarded as DB, with the accompanying slew of regulations, which make such plans very unattractive and costly to administer.

The Dutch, for example, for many years have been operating successful collective DC systems, not without the occasional mishap but at much lower cost for each dollar of benefit. And Germany and Scandinavia operate book-reserve

plans, which are largely outside the control of the European Pensions Directive, and are simple and cheap to manage. Although some countries are hostile to forms of plan with which they are unfamiliar, it can only be a matter of time before there is welcome competition in the provision of benefits using the wide range of plans available throughout the European Union. For example, with some exceptions, book-reserve plans are not used in the United Kingdom, but could be established without much effort either in the United Kingdom or if necessary in Germany, for example.

FUNDING OF DEFINED BENEFIT SYSTEMS

The funding of schemes has been explored in some depth above when discussing the role of the new regulator. As mentioned, the financial collapses in 2007/2008 provoked the authorities to build in additional protection to support the stability of financial institutions. Insurance companies, for example, although only slightly affected directly by the fall-out (with AIG being a notable failure, but not because of its insurance activities) nonetheless are now being faced with the requirements of Solvency II, to ensure greater reserves as security. Most insurers have accepted their fate, even though it has increased the cost of products. Insurers of course also operate in the pensions field, and have been unhappy with the fact that company-sponsored pension arrangements do not (at present) need under the Solvency II requirements the same kind of reserves; they consider it unfair competition and have sought the famous level playing field. Pension funds, on the contrary, (and their sponsors) complain that their full capital backs the pension promises and to insist on Solvency II requirements would simply lead to the dismantling of such DB schemes as still exist.

At present, it is not certain which way the European Union will go; nonetheless, it is well aware of the issues of unintended consequences; Michel Barnier rather elliptically mentioned that he as well aware that was necessary for insurers might not be necessary for pension funds, but reserved the right to do just that.⁴³

Solvency II

In April 2011, the EC sent EIOPA a formal 'Call for Advice' to help its review of the IORP directive, which provides a framework for the regulation of funded occupational pensions in Europe. The publication of EIOPA's final advice followed two consultations in July and October 2011 on its draft advice. The most significant of EIOPA's proposals is the 'holistic balance sheet', which could potentially require UK DB schemes to be funded on at least a 'full buy-out' basis.

Its publication was coincidental with the EC white paper (see above). A key issue raised in the green paper preceding the white paper was the suggestion that the solvency regime for pension funds could be improved and that the Solvency II approach, which applies to insurance companies, could be a good starting point.

The EU Commission's review of the IORP directive was prompted by its wish to promote the use of cross-border schemes (currently rarely used), the desire for a level playing field between pensions and insurance and the perceived need for EU-level risk-based supervision.

Its key proposal was the concept of a 'holistic balance sheet' regime, introduced by EIOPA in its October 2011 consultation. This is a framework intended to achieve the EC's aim of establishing a prudent regime for IORPs that provides a similar level of security between IORPs. The proposals put forward by EIOPA are largely unchanged from its consultation. For funded DB schemes, this could mean valuing the scheme's liabilities on a risk-free discount rate and including an allowance for capital requirements, which is an expensive hobby. However, some 'value' of the sponsor covenant and possibly also potential recourse to the PPF could be included when measuring the assets available to the scheme.

The holistic balance sheet could also be applied to DC schemes with possible cost implications if DC schemes were required to hold additional capital against operational risk.

EIOPA noted in its final advice that it was unable to consider the question of whether Solvency II was 'the right place to begin a review of the IORP directive' because this was not a question that was asked by the EC.

EIOPA added that the EC 'may want to consider some of the wider issues raised by consultation respondents which are outside the scope of EIOPA's advice'. The EIOPA proposals are conditional on the results of a quantitative impact assessment, the results of which it was to publish in the second half of 2012.

Most countries in the European Union that operate funded DB systems were deeply critical. EU employer, worker and industry representatives issued a joint press release saying 'we believe that it is dangerous to apply legislation made for insurance companies to IORPs Any effort to harmonise the regulatory regime is based on flawed logic and could have unintended consequences on pension plan members, IORPs and the economy as a whole by impeding growth and job creation'.

The EU commissioner responsible for the review of the IORP directive, Michel Barnier, in a speech on 1 March 2012 to launch the review of the IORP Directive formally, referred to the press coverage of the review, suggesting that some of it was 'hyperbole'. He noted that the EC had not yet put forward any proposals and said that there was no 'question of penalising systems which are working well'. Although the approach of Solvency II would be drawn on, he said 'there is no question of "copying and pasting" this approach onto the pension funds sector'. However, he also emphasised that a level regulatory playing field was essential and that proposals for pension fund regulation 'will not be done with a "silo mentality"' and must draw on 'some useful aspects of Solvency II'.

CONCLUSIONS

The survey above tackles the main themes of EU intervention in the pensions arena; there are, however, many other areas of intervention including:

- Data protection⁴⁴
- The sale of variable annuities⁴⁵
- Information for members⁴⁶
- Money laundering⁴⁷

and numerous other minor interventions.

The European Union is not yet finished with its interventions; it is determined unfortunately to devote its efforts more to regulation in the ever-vain attempt to prevent failure, and less to the opening of the markets, which is what the original brief for the European Pensions Directive intended.

Finally, it is to be expected that there will be further explorations by the European Court of Justice as it equally vainly attempts to enforce the ability to establish pension systems across borders against the wishes of the domestic tax authorities. The only thing missing is the dream of simplicity,⁴⁸ any future article on the issue is likely to be even longer than this one.

Implications for employers

For employers, the implications seem material. They include:

- Increasing opportunities for cross-border provision of occupational pension systems, with reduced costs and spread risks
- Improving investment vehicles in certain member states
- Increased competition among member states and their regulators, despite the cartelising efforts of EIOPA
- Continuing regulatory arbitrage
- Simplification of pension provision
- Growth of book-reserve systems to avoid funding costs

The speed with which this will happen is uncertain, but the velocity of change seems likely to increase.

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- 2 *ibid*; see also European Commission, *Green paper: Towards adequate, sustainable and safe European pension systems*, Brussels, 7 July 2010, COM (2010)365. See also European Commission, *Dealing with the impact of an ageing population in the EU (2009 Ageing Report)*, Luxembourg, 2009, COM (2009) 180, ISBN 978-9279113639.
- 3 *France Telecom*, EU reference IP/11/1577, Brussels, 20 December 2011 (State aid: Commission approves financing of retirement pensions of public service employees working for France Telecom subject to certain conditions). The non-confidential version of the decision will be made available under the case number SA.22553 in the State Aid Register on the DG Competition Website once any confidentiality issues have been resolved. New publications of state aid decisions on the Internet and in the Official Journal are listed in the State Aid Weekly e-News. The European Commission launched an in-depth investigation in May 2008 following a complaint (see IP/08/765). The public service employees concerned represent some 40 per cent of France Télécom's staff. The decision concerns only France Télécom's specific retirement scheme and was unrelated to the reform of pension schemes under way in France.
- 4 *European Union v United Kingdom (Royal Mail state aid)* (2011) 087 PBLR (European Court of Justice: Referral from HM Government re state aid, 29 July 2011, (European Union – State aid – Funded pension schemes – Scheme in deficit – Privatisation – Removal of pension liabilities)). The Commission has subsequently permitted the transaction but the terms were not available at the time of writing. See also The Postal Services Act 2011 (Taxation) Regulations 2012, which (possibly unfairly) are intended to remove any unintended tax consequences of the transfer of assets and liabilities by the Royal Mail of the Royal Mail Pension Plan to the government.
- 5 Which it is understood would be available by June 2012. The UK government as part of the exercise gained ownership of £35B of pension schemes assets (and £45B of liabilities).
- 6 See generally Dirk Broeders, Niels Kortleve, Antoon Pelseer and Jan-Willem Wijkmans, *European pension supervision*, (2012) (April) Investment and Pensions Europe 32, which focuses on the 'holistic balance sheet' (HBS) option, rather than the Solvency II option.
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- to old-age benefits, including survivors' benefits, under supplementary occupational or inter-occupational pension schemes outside the national statutory social security schemes'.
- 10 *Wedgwood Museum Trust in administration* (2012) 023 PBLR (013) (2011) EWHC 3782 (Ch) United Kingdom: England and Wales: High Court: Chancery Division: Birmingham District Registry, 2011 December 19, (Multi-employer schemes – Group schemes – Deficits – Whether last participating employer liable for deficit).
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 - 13 See, for example, *Danner*, ECJ Case C-136/00; *Wielcokx* (1995) ECR I-2493 ECJ Case C-264/96; *Safir* (1998) ECR I-1897 ECJ Case C-118/96; *Bachmann* ECJ Case C-204/90, (1992) ECR I-249; *Commission v Belgium* ECJ Case C-300/90 (1992) ECR I-305, and many other cases, most of them ignored by the authorities of individual member states.
 - 14 A Pension Fund Pooling Scheme (PFPS) in the United Kingdom, for example, is an unauthorised unit trust where all the investors are approved UK or overseas pension funds. If it satisfies conditions set out in the PFPS regulations (SI 1996/1585) regarding the nature of the trust and its investments then the special rules in Section 469 ICTA and Section 99 TCGA that apply to unauthorised unit trusts are set aside (SI 1996/1583 and SI1996/1585). The effect of this is that income arising from the investments held by the scheme arises directly to the investors for tax purposes. This means that the trustees of the scheme do not deduct income tax from payments of scheme income to investors (as they would have to under Section 469 ICTA) and that an overseas pension fund can make double tax treaty claims in its own right in respect of its share of the income arising from scheme investments. There are similar arrangements in other member states, most notably Ireland and Luxembourg.
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 - 25 *Nortel Networks UK Pension Plan and Pension Protection Fund* (2012) 012 PBLR (019) United States: Third Circuit: Court of Appeals (Philadelphia), 29 December 2011 (Bankruptcy – Insolvency – United States – Whether a UK regulator has rights to delay bankruptcy procedures in the United States – Whether a government agency – Whether 'police powers' apply – Whether a UK financial support direction has priority over Chapter 11 agreements – Extraterritorial jurisdiction of financial support direction).
 - 26 Michel Barnier, the European Commissioner, in a speech on 10 February 2012 suggested that 'we will inspire ourselves from the Solvency II approach when appropriate but that does not mean we will "copy and paste" Solvency II'; see also a similar pronouncement at the Commission's public hearing on 1 March 2012.
 - 27 See, for example, the absurd Pension Protection Fund, *Statement on equalisation for GMPs and the application of a statutory minimum to PPF compensation for schemes in a PPF assessment period*, PPF, p. 187, November 2100; Department for Work and Pensions, *A possible method for equalising pensions for the effect of the Guaranteed Minimum Pension, part of the consultation on draft regulations*, DWP, January 2012, p. 37; The Occupational Pension Schemes and Pension Protection Fund (Equality) (Amendment) Regulations 2012, London (draft, January 2012).
 - 28 *Barber v Guardian Royal Exchange* (1990 01 30 (AG); 1990 05 17 (ECJ)) (1990) 2 All ER 660; (1990) PLR 95; (1990) 2 CMLR 513; (1990) 1 ECR 1889; (1990) 06 PBLR (049); (1990) ICR 616; (1991) 1 WLR 72; (1990) IRLR 240; Case C-262/88 (1991) 1 QB 344.
 - 29 *Römer v Hamburg* (2011) 058 PBLRECJ Case C-147/08 European Union: European Court of Justice: reference from Arbeitsgericht Hamburg, 10 May 2011 (Equal treatment – Discrimination – Civil partners – German – European Union – Whether civil partners must be granted the same supplementary pensions as married partners).

- 30 *Belgian annuities* (Test-Achats) (2011) 029 PBLR, ECJ Case C-236/09 (European Union: European Court of Justice: Reference from Belgian Constitutional Court, 1 March 2011) (Discrimination – Equal treatment – EU Gender Directive – Application to insurance premiums for men and women – Whether objective justification – Whether legislative exemption justifiable).
- 31 European Commission, *Communication from the Commission: Guidelines on the application of Council Directive 2004/113/EC to insurance, in the light of the judgment of the Court of Justice of the European Union in Case C-236/09 (Test-Achats)*, Brussels, 22 December 2011 C (2011) 9497 final.
- 32 See, for example, Regulation (EEC) No 1408/71 of the Council of 14 June 1971 on the application of social security schemes to employed persons and their families moving within the Community, and amending regulations.
- 33 Directive 98/49/EC on safeguarding the supplementary pension rights of employed and self-employed persons moving within the Community.
- 34 The Commission adopted on 20 October 2005 a proposal for a Directive on improving the portability of supplementary pension rights (COM (2005) 507 final).
- 35 See on portability issues, Commission of the European Communities, Brussels, 20 October 2005 COM (2005) 507 final, 2005/0214 (COD), Proposal for a Directive of the European Parliament and of the Council on improving the portability of supplementary pension rights {SEC (2005) 1293\} (presented by the Commission). See also European Commission, *Quantitative overview on supplementary pension provision, Final Report*, November 2007, prepared by Hewitt. And see Coppin & Vandenbrande, *The mobility profile of 25 EU member states*, EU, Brussels, 2007.
- 36 Directive 2003/41/EC of the European Parliament and the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision (IORP Directive). It has been implemented in member states by domestic legislation; in the United Kingdom; see, for example, Occupational Pension Schemes (Cross-border Activities) Regulations 2005 (SI 2005 No 3381). See also to almost certainly flawed UK implementation in: <http://www.thepensionsregulator.gov.uk/guidance/guidance-cross-border-schemes.aspx>.
- 37 In the United Kingdom, see Pensions Act 2004 ss287–295; The Occupational Pension Schemes (Cross-border Activities) Regulations 2005 SI 2005 no 3381; Occupational Pension Schemes (EEA States) Regulations 2007 SI 2007 No 3014.
- 38 *Klein v Austria* (2011) 045 PBLR, (2011) ECHR 389 International: European Court of Human Rights: First section 3 March 2011 Vesting – Preservation – Forfeiture – Human rights – Whether pension can be forfeit for conduct unbecoming – Lawyer's pension – Whether pension is a property right capable of protection.
- 39 *Casteels v British Airways* (ECJ) (2011) 048 PBLR, ECJ Case C-379/09 European Union: European Court of Justice: Reference from Arbeidshof te Brussel (Belgium) 10 March 2011 (European Union – Freedom of movement of workers – Migrant workers – Preservation – Vesting – Whether preservation applies to years of service in different member states – Whether lack of preservation amounts to discrimination).
- 40 See, for example, The Employment Equality Directive 2000/78/EC; or The Employment Equality (Age) Regulations 2006 SI 2006 no 1031 (in the United Kingdom).
- 41 *Fuchs v Land Hessen* (2011) 077 PBLR, ECJ Case C-159/10 (ECJ Case C-160/10) European Union: European Court of Justice: References for a preliminary ruling from the Verwaltungsgericht Frankfurt am Main (Germany), 21 July 2011 (Equal treatment – Discrimination – Age discrimination – Whether fixed retirement age objectively justifiable – Grounds for justification).
- 42 *Prigge v Deutsche Lufthansa* (2011) 088 PBLR ECJ Case C-447/09, European Court of Justice: Reference for a preliminary ruling under Article 234 EC from the Bundesarbeitsgericht (Germany), 13 September 2011, Equal treatment – Retirement ages – Airline pilots – Whether imposition of retirement ages is justifiable in collective agreement where not imposed by general law).
- 43 Michel Barnier, member of the European Commission, responsible for internal market and services, *Towards a real single market for occupational pensions offering greater choice and better protection for pensioners, public hearing on the revision of the Directive on occupational pensions*, Brussels, 1 March 2012, Speech/12/141; EIOPA, *EIOPA's advice to the European Commission on the review of the IORP Directive 2003/41/EC*, EIOPA-BIS-12/015, 15 February 2012, p. 600. A revised draft text of the IORP Directive is expected to be published by the end of 2012.
- 44 Directive 95/46/EC on the protection of individuals with regard to the processing of personal data and on the free movement of such data. On 25 January 2012, the European Commission issued a draft European Data Protection Regulation intended to supersede the Data Protection Directive.
- 45 European Insurance and Occupational Pensions Authority. Report on good practices for disclosure and selling of variable annuities, EIOPA CP 11/007, 4 April 2012, p. 16.
- 46 European Insurance and Occupational Pensions Authority. Report on pre-enrolment information to pension plan members, EIOPA BoS-11/039, July 2011.
- 47 BA, ESMA and EIOPA's Report on the legal and regulatory provisions and supervisory expectations across EU member states of simplified due diligence requirements where the customers are credit and financial institutions under the third money laundering directive 2005/60/EC, JC/2011/097, AMLTF/2011/07, April 2012; EBA, ESMA and EIOPA's Report on the legal, regulatory and supervisory implementation across EU member states in relation to the beneficial owners customer due diligence requirements under the third money laundering directive 2005/60/EC, JC/2011/096, AMLTF/2011/05, April 2012; European Commission, Report from the Commission to the European Parliament and the Council on the application of Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, Brussels, 11 April 2012, COM (2012) 168 final. Pension plans are not the obvious vector for terrorist financing, but you cannot be too careful.
- 48 Although there is indeed a programme for the simplification of financial services regulation (a Lamfalussy initiative), which has been all but forgotten in the wake of the financial crisis.