

Consultation report

February 2006

Cross-border schemes

The approach to implementation
by the Pensions Regulator

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1. Introduction and executive summary

The consultation on the overall approach to the implementation of cross-border schemes was published on 9 November 2005 and invited respondents to comment on:

- how the authorisation and approval processes would be operated;
- how the funding requirements would work; and
- the approach to supervision on cross-border schemes.

The paper was effectively asking about what sort of regulator the Pensions Regulator wished to be in relation to cross-border schemes, given its own statutory objectives and the commercial imperatives that arise from cross-border initiatives.

The overall response to the consultation was small but positive. The responses were received before final regulations were made public.

Seven responses were received in total, four from trade associations, all of whom had been able to table the issue at committee meetings or garner views from their members. One of the responses came from a Brussels-based association representing European employer views (both the NAPF and ABI belong to this group).

This formal written consultation is only one of a number of measures taken to determine stakeholder viewpoints.

A summary of the written comments received from respondents, along with the Pensions Regulator's response, is outlined below.

The Pensions Regulator's risk-based approach must evolve for cross-border schemes over time. Further work is needed around host state obligations and home state supervision issues.

2. What consultation has taken place?

2.1 Pre-consultation

The views of schemes with a multinational employer and advisers were sought during a pre-consultation period in which the impact of the cross-border requirements on these schemes, and its consequent views on regulation, were thought through.

As in the Department for Work and Pensions (DWP) talks with industry on this issue, there was a strong demand to avoid the immediate impact of the European legislation, together with a desire to avoid too high a regulatory burden on those schemes that did wish to take advantage of the opportunities offered by the cross-border arrangements.

2.2 Consultation period

The formal consultation on the overall approach was published on 9 November, with a very time constrained proposed period for consultation of just four weeks.

The reasons for such a short consultation period were fully explained in the document. In summary, they were:

- the commencement date of the regulations;
- that the cross-border requirements are entirely new (hence limited consultation was much more preferable than no consultation);
- that existing UK-Irish schemes were already operating cross-border and needed to be fully and quickly aware of their special situation; and
- that the funding requirements for cross-border schemes are stricter and have more immediate effect than those for domestic schemes.

2.3 Other means of engaging with stakeholders

To counter-balance the shorter than usual consultation period, the Pensions Regulator adopted various strategies to minimise the impact of a short consultation period. The Pensions Regulator sought to capture views during pre-consultation, sought expressions of interest via a website facility and invited schemes involved with scheme returns to consider whether they were 'European' or not.

Those that registered an interest via the scheme return or the website received a mailing directing them to the guidance and to the made regulations. They also received an invitation to joint 'awareness sessions' set up by the DWP and the Pensions Regulator – these took place in January and February and provided a further opportunity to the industry to give feedback to the Pensions Regulator.

2.4 Conclusion on the consultation arrangements

No comment, adverse or otherwise, was received on the length of the consultation period. The reasons for the short consultation period were fully accepted and the views received from all channels were relatively comprehensive for what is currently an issue affecting only a minority of schemes.

3. Summary of responses to consultation

The following section summarises our responses to the points raised in answer to the specific questions asked in the consultation document.

Each question is preceded by a summary of the essence of the question.

Question 1: the overall strategic approach

Are you in agreement with the preferred overall approach of the Pensions Regulator?

Five respondents answered this in the affirmative, two expressed reservations.

There was agreement around:

- the risk-based approach ‘recital 4 of the directive states that there should be ‘prudential supervision’ and taking a risk-based approach ties in with this’ (quote from the European Federation for Retirement Provision – EFRP);
- the need not to stifle potential commercial opportunities (particularly from the commercial providers) in this area by setting the regulatory hurdle too high;
- that due care and consideration had been given to proportionality and that due recognition had been given to the need for proper exercise of discretion from a regulator; and
- factors cited in a proportionate risk-based response included the overall size of the scheme and the size of the cross-border element; the need to develop intelligence systems to support the risk-based approach.

Concern was expressed around:

- time limits – the Association of Pension Lawyers (APL) stated that if the regulator took the maximum time limits available under the directive to effect authorisation and approval, this would seriously undermine schemes’ activities; and
- the whole ‘notification’ (ie, authorisation and approval) processes – the EFRP take the view that these processes could be much simpler and still meet with directive requirements.

The Pensions Regulator's response

- *Work is going ahead on risk-based regulation generally within the Pensions Regulator. The regulator is mindful of the need not to stifle commercial initiatives and the risk-based processes for cross-border schemes are being developed with these factors in mind.*
- *The EFRP view has not been taken up generally in Europe, and in particular in our legislation which does require schemes to seek prior authorisation and approval. However, within the legislative framework, the Pensions Regulator will seek to implement a proportionate and risk-based response.*
- *We note the concerns over time limits and will endeavour to provide an approval process that is efficient and fast. However, given the novel nature of the process, schemes may have to build the potential maximum time limits into their planning. There are also very critical time limits for existing schemes in the legislation and these schemes will be dealt with these cut-off dates in mind.*

Question 2: the authorisation process

Do you agree with our preferred choice to adopt option 3.5.3(ii) in relation to the authorisation process?

- In general, respondents thought that option represented a suitable risk-based way at this first stage in the notification process. The proposal was the appropriate balance between a total self certification approach and an over-scrutiny of each detail of each application, especially as this first stage by itself did not allow for the scheme to operate cross-border.
- Exceptionally, the Brussels-based group, the EFRP, took the view that the approval process set out was not required by the directive. Their view is that the same results, and the same level of prudential control, could be achieved via a 'blocking' system.

The Pensions Regulator's response

- *The Pensions Regulator is bound by the regulations to give effect to a prior authorisation and approval process.*

Question 3: the approval process

Do you agree with this approach to the implementation of the approval stage?

- There was general agreement that there needs to be effective control over cross-border activity. There was general agreement also about the balance of scrutiny at the approval stage.
- The risk-based approach was endorsed - the good reputes of schemes should be assumed, unless the Pensions Regulator intelligence suggests otherwise.
- One respondent pointed out that the concept of cross-border schemes was in its infancy and that very few providers had well developed plans as yet. However, the Pensions Regulator needs to respond flexibly within its remit of protecting members' benefits.
- One respondent did not see how giving greater scrutiny to schemes with proposals to bring in large numbers of EU members was compatible with the stated intention not to discourage commercial interests in this area.

The Pensions Regulator's response

- *The Pensions Regulator in developing its risk models will make adjustments in its approach in line with the intelligence it has and receives on an issue. The balance of members argument was merely an illustration of one factor in a risk-based approval process which could be mitigated by other risk factors in the same scheme.*
- *The EFRP re-iterate their objection to an approval process. They would prefer to see the regulator using clear risk-based criteria to filter out and block problem cases, therefore prior approval would not be needed. The response to this is as for question 2 above.*

Question 4: Supervision

Do you agree with the proposed approach to supervision?

- Overwhelmingly, respondents appreciated that the same supervisory approach would be put in place for cross-border as for domestic schemes and that the Pensions Regulator would be issuing scheme returns and receiving whistle-blowing and other reports.
- The APL commented that much of the supervisory approach depended upon the terms of the protocol.

- The EFRP wanted to see more detail around the regulator as a host state authority and how it might enforce social and labour law. Would there be action taken against the UK sponsor and could there be resumption of cross-border activities once the problem was resolved.
- Would these pension schemes invite more scrutiny?
- Would there be a bedding in period for new cross-border schemes?

The Pensions Regulator's response

- *There will be a 'watching brief' on supervisory systems to ensure that sufficient use is made in particular of the reporting processes in relation to cross-border schemes.*
- *It is hoped that the protocol will be signed in February 2006 and this will of course set out some standards for the co-operation between supervisors on cross-border schemes.*
- *Schemes without any recorded wrongs may enjoy a lighter supervisory touch in the future – but this depends upon the outcome of current industry discussions. This could mean the converse for those that had breached any aspect of the cross-border requirements but any scheme that lost its authorisation or approval could re-apply. The regulations on cross-border schemes do take effect from 30 December. Some of those regulations allow schemes some leeway – for example, new schemes have two years from the effective date of application before they become fully funded.*
- *We accept the need for some further analysis in respect of social and labour laws.*

Question 5 – ring fencing

Do you agree with the proposed approach to ring fencing?

- There was general agreement with the proposed approach with particular endorsement for notional, rather than actual, ring fencing. One respondent wanted to see the cross-border element of a scheme ring fenced in relation to the funding requirements and, where used as a supervisory tool, for there to be perhaps 'degrees' of ring fencing.
- The same respondent also felt that an overzealous approach to supervising the full funding requirements was not needed.
- Generally, the potential for ring fencing to impair the potential economic performance of a scheme was acknowledged although

one respondent did not see it as a drastic measure, compared with say contribution notices.

The Pensions Regulator's response

- *The funding requirements on cross-border apply to the whole scheme or schemes and cannot be segregated in the way suggested. Similarly, the requirements on funding as transposed into the regulations gives the regulator less flexibility around recovery periods on funding than the authors of the response suggest.*

Question 6: any other comments

Are there any other comments that you would like to make about cross-border schemes and their regulatory arrangements?

- The EFRP particularly welcomed this example of consultation and suggest that other supervisory authorities when considering their cross-border arrangements should follow suit.
- One respondent asked, can the three months for approval be reduced at all, perhaps by running concurrently with the notification to the host?
- There was a request for a three year review, especially to identify if there are any obstacles to the setting up of these schemes and what could be done to encourage multi-national employers to set up these schemes.

The Pensions Regulator's response

- *Thank you to those respondents who took the trouble to respond. We appreciate that this is just the beginning of what may be necessary to set out the cross-border arrangements to the relevant stakeholders.*
- *The plea for fast track approval processes has been noted. The three months is the maximum time period allowed for approval and not necessarily an operational standard. The notification to the host regulator can only take place after the approval has been given so cannot run concurrently. However, the Pensions Regulator is developing relationships with other EU regulators and would hope to bring some influence to bear on time scales at the host end of the process.*
- *The Pensions Regulator will be working in four years' time with the DWP on a review of the made regulations and the regulatory processes and their impact on stakeholders within the industry.*

4 List of respondents

Legal and General Assurance Society Limited

A Pension Scheme (CONFIDENTIAL RESPONSE)

AEGON UK

Association of Pensions Lawyers (APL)

Association of Consulting Actuaries (ACA)

Association of Pensions Consultants (APC)

The European Federation of Retirement Provision (EFRP)