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## All change for EU pension rights?

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**Pensions analysis: What will new EU rules on the acquisition and preservation of supplementary pension rights mean in practice? Richard Evans and Jonathan Moody, partners at Mayer Brown International LLP, explain the purpose of the new rules and how they could affect current UK pensions legislation.**

### Original news

Official Journal of the European Union, L128, 30 April 2014--Directive--Free Movement of Workers, LNB News 30/04/2014 97

*Directive 2014/50/EU of the European Parliament and of the Council, which comes into force on 20 May 2014, concerns minimum requirements for enhancing worker mobility between member states by improving the acquisition and preservation of supplementary pension rights.*

### What is the purpose of the Directive?

The Directive is intended to promote the free movement of workers between EU member states. It requires member states to ensure that, for 'outgoing workers'--broadly employees who move to another member state after their current employment ends--any 'supplementary pension scheme' relating to their current employment meets certain standards, specifically as regards the vesting and preservation of pension rights, and the disclosure of related information.

Member states have until 21 May 2018 to take any steps necessary in order to comply with the Directive.

While sometimes said to cover 'portability', the Directive lays down no requirements about the transfer of pension rights from one scheme to another. Nor does the Directive have anything to say about cross-border schemes or the harmonisation of tax rules as between member states.

### What pension protection does the Directive offer to outgoing workers?

Member states must ensure that schemes meet the following standards:

- o Any waiting period and/or vesting period for an outgoing worker must not exceed three years in aggregate.
- o Any minimum age for outgoing workers' rights to vest must not be higher than 21.
- o If an outgoing worker leaves service before benefits have vested, the scheme must refund contributions paid by or on behalf of the worker (or alternatively a money purchase scheme may refund the relevant part of the member's pot).
- o If an outgoing worker leaves service after benefits have vested, it must be possible for those rights to be preserved in the scheme. Preserved rights must be treated in line with the rights of active members or with pensions in payment or in some other way which is 'considered as fair'. The Directive expressly gives the example of revaluing outgoing workers' accrued rights in

accordance with the inflation rate subject to a proportionate limit set by national law in the member state. As an alternative, preserved rights which are below a triviality limit set by the member state may be discharged by payment of a lump sum, subject to the worker's informed consent.

- o Members must be provided on request with specified information about the acquisition of pension rights, any rights which have actually vested, and the terms on which rights are preserved in the scheme.

These standards apply in respect of 'supplementary pension schemes'. These are defined as 'occupational pension schemes...linked to an employment relationship', but the preamble to the Directive indicates that this covers group personal pension schemes and unfunded arrangements, and workplace pensions generally.

However, there are two significant carve-outs. The Directive will not apply:

- o to schemes which are closed to new members, or
- o to pension rights built up before the relevant member state implements the Directive

Additionally the Directive does not apply to ill-health benefits or to survivors' benefits (though where a scheme does promise survivors' benefits to outgoing workers, it seems that the revaluation and disclosure requirements will apply to those benefits) (see arts 2.3, 5.2 and 6.3).

### **What conditions must a worker satisfy to benefit from this protection?**

Here there is another carve-out which appears important. The provisions of the Directive about the vesting and preservation of pension rights apply only to outgoing workers. An outgoing worker is defined as 'an active scheme member whose current employment relationship terminates for reasons other than becoming eligible for a supplementary pension [this seems to exclude people who draw an immediate pension on leaving employment from the definition] and who moves between member states'. The Directive states expressly that its provisions do not apply in respect of workers moving within a single member state.

In theory, therefore, a member state might legislate to say that schemes must meet the relevant standards in respect of those outgoing workers, but not in respect of early leavers who never move to another member state. But it is difficult to see how this selective approach could work in practice--a scheme has no way of knowing at the point when employees leave service, let alone when they are first hired, whether they will later move to another member state. (Some commentators expected the Directive to give these rights only where an 'outgoing worker' moves to another member state within two years after leaving their current employment, but there is nothing to that effect in the final version of the outgoing worker definition). The scheme might not know till many years later whether or not a particular individual's rights should have been preserved.

It is even harder to see how a scheme could apply a four-year waiting period before admission to non-outgoing workers, while applying a waiting period of at most three years (for waiting period and vesting period combined) to workers who later move to another member state. Even if the scheme retrospectively granted the member an extra year's service when he or she moved, how could it recoup the extra contributions that the member would have paid in that extra year?

In practice, this carve-out may give schemes and employers less scope to differentiate between members who do and do not move abroad than the Directive suggests.

### **How does this affect current UK pensions legislation?**

The government is said to be confident that UK law already meets the requirements of the Directive. By and large, that must be correct. For example, in UK occupational pension schemes proper:

- o The maximum vesting period allowed by law is two years (see the Pension Schemes Act 1993, ss 69-82 (PSA 1993)). The government intends to cut the period to 30 days for workers who join money purchase occupational schemes (see the Pensions Bill 2013-14, cl 36).
- o There are statutory rules about the revaluation of preserved pension rights (see PSA 1993, ss 83-86) and the disclosure of information (see the Occupational and Personal Pension

Schemes (Disclosure of Information) Regulations 2013, SI 2013/2734), which appear to meet the standards laid down in the Directive.

There are, however, a number of question marks:

- o Current UK legislation (the Equality Act (Age Exceptions for Pension Schemes) Order 2010, SI 2010/2133, art 6) permits waiting periods of up to five years before an employee is admitted to a scheme (though not if the scheme is being used for auto-enrolment). In effect, therefore, UK law permits waiting and vesting periods of seven years in aggregate--substantially longer than the three years specified in the Directive.
- o An early leaver without vested benefits does not have a statutory right to a refund of contributions unless he or she has completed three months' pensionable service (see PSA 1993, ss 101AA-101AI and the Pensions Act 2008, s 8).
- o UK legislation allows preserved benefits to be transferred, or bought out, without members' consent in some circumstances. Query whether that might be inconsistent with the requirement of the Directive that member states must ensure that outgoing workers' pension rights 'can remain in the [scheme] in which they vested' (art 5.1(c)). The preamble to the Directive suggests that it is permissible if 'outgoing workers are afforded the possibility' of transfers to another suitable pension scheme. But letting members transfer voluntarily is not quite the same thing as transfers and buy-outs without consent.
- o UK law also allows members to lose some or all of their accrued rights in some circumstances. That can happen if they get divorced and a pension sharing order is made or, for example, if a member has committed a fraud and owes money to his or her employer as a result (see the Pensions Act 1995, ss 92, 93). Provisions like these seem to conflict with art 5.1(c), though there may be an argument that the preamble to the Directive implicitly permits them even for outgoing workers--para 22 says that the Directive does not create any obligation to treat dormant pension rights more favourably than active members' rights.
- o There is currently no legal duty to 'preserve' rights in unfunded private sector schemes which have not been registered under the Finance Act 2004 (*Royal Masonic Hospital v Pensions Ombudsman* [2001] 3 All ER 408, [2000] All ER (D) 2390). In principle the Directive would impose a preservation duty on these scheme, unless a carve-out applies. However, in many cases a carve-out may apply in practice--many existing unfunded schemes are single-member arrangements which could be seen as closed to new joiners.
- o The Directive requires schemes to refund the contributions paid 'by...or on behalf of' outgoing workers who leave before their rights have vested. It is not 100% clear what contributions paid 'on behalf of' a worker means. If they include contributions that the employer has made on the member's behalf under a salary sacrifice arrangement, there may be an issue under tax law. Member contributions can be refunded to members who leave service before their rights vest, but paying employer contributions--even ones made under salary sacrifice--to a member without vested rights is an 'unauthorised payment' under the Finance Act 2004.

### **Are there any steps pensions lawyers should take to reflect the adoption of the Directive?**

Probably not--it's a case of 'wait and see'. Even if the government concludes that UK law needs to change in order to comply with the Directive, changes would not need to be made until May 2018. Furthermore such changes might not be on an 'across-the-board' basis, given the significant carve-outs under the Directive.

*Interviewed by Rachel Moloney.*

*The views expressed by our Legal Analysis interviewees are not necessarily those of the proprietor.*