

# *Protection for pension scheme members in times of financial crisis: looking beyond national competencies<sup>1</sup>*

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*Abstract.* Occupational pension schemes are particularly vulnerable to the negative economic and political consequences of global financial uncertainty. This is especially evident in a country such as the United Kingdom which has an historic prevalence of defined benefit occupational pension funds, many of which now have large deficits. It is argued in principle that individual scheme members benefit from a supranational influence on occupational pensions, that the European Union is best placed to provide such support, but that the European Union's role in pensions can be improved. The key themes are particularly relevant to pension scheme members in the United Kingdom following the decision to leave the European Union in a referendum on 23 June 2016.

*Keywords:* European Union, occupational pensions, financial crisis.

*JEL Codes:* G22, H55, J26.

## **1. Introduction**

European political systems still operate in a state of uncertainty after a significant period of financial turmoil, following the collapse of several banks in the US in 2008 and the sovereign debt crisis in the EU in 2010. The European political, social and economic consequences are particularly evident following economic adjustment measures imposed by the EU on Portugal, Greece and Ireland as conditions of the financial 'bailout' packages to address the crises. Ashiagbor observes that the economic crisis has accelerated the trend of deregulation of labour law standards and advocates an increased role for the European Commission and the International Labour Organisation to address injustices [Ashiagbor 2013]. Casey observes that

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<sup>1</sup> This article was presented at the ENRSP conference hosted by the University of Gdańsk in September 2016. Since then the recast IORP directive has been passed and became law on 12 January 2017 and is due to be implemented by Member States before 13 January 2019. Following the referendum decision in the UK, the formal process to leave the EU was begun by the triggering of Article 50 of the Treaty on European Union on 29 March 2017.

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the financial crisis developed through several ‘mutations’ originating in a credit crisis, evolving to a crisis of government finance and a crisis of European cohesion that has increased the pace of pension reform [Casey 2012]. Funded occupational pension schemes are particularly vulnerable, due to the temptation for national governments to see large pension funds as potential sources of revenue, for example through changes to taxation rules.

It is suggested that a supranational legal and political influence is an important part of any country’s pension system. Occupational pensions have an essential role in social welfare, particularly in a country such as the UK which has a low state pension and has introduced automatic enrolment which obliges employers to register employees into pension schemes as well as to contribute towards them. Such an influence already exists in the form of the European Union’s legislative and judicial institutions. However, increasing dissatisfaction with the EU and the decision of the UK to leave the EU in a national referendum on 23 June 2016, brings into focus the important question of whether such an influence is necessary. It is argued that for a harmonious relationship between the EU and occupational pensions: the EU institutions need to engage with the diversity of numerous national systems to ensure that such initiatives fit within the particular country’s framework and to take action to empower national stakeholders. It is beyond the scope of this paper to consider the full range of legislative and judicial structures which are available to the EU or to enter into detail about how the proposed relationship could operate. However, in order to develop the argument for a positive role of the EU in occupational pensions, as the current occupational pensions directive [Directive 2003/41/EC OJ L235] has been revised and the new version is likely to come into legal force two years after final approval later this year, some comments are made in light of the latest draft of this directive (referred to as “IORP II”) in respect of the UK system.

Section 2 below considers the potential for policy decisions to affect the security of occupational pensions negatively in the case of the UK. Section 3 addresses the potential of existing EU structures to have a positive role in occupational pensions, Section 4 suggests how interaction with the national framework could be better achieved and Section 5 concludes.

## 2. Policy implications for national pension systems

In times of financial crisis, government decision making often focuses upon maximising revenue and saving costs. From a national perspective, the situation of occupational pensionschemesintheUKhastheadedcomplexityofastrongregulatorandthetrustlaw framework within which a typical occupational pension scheme operates. In the context of the financial crisis, it was proposed by Askins that the government should pursue a strategy of dramatic reform which addresses the structures and traditional methods of pension provision [Askins 2010]. Conversely, it has even been suggested that some areas of pensions policy should not be a matter for government, but should be

governed by an independent pensions commission in order to protect scheme members from irresponsible government policy [Bell 2016]. It is suggested that whichever direction policy decisions may lead, there are particular benefits from an EU dimension, but with increased roles for national stakeholders. Greater engagement and power for national stakeholders with EU wide policy could lead to better protection for scheme members and protect against government inclinations to sacrifice pensions for short term financial gain.

In the UK, the prevalence of funded defined benefit schemes means that the pensions industry is particularly susceptible to changes to taxation. It was reported last year, that pension fund assets of over £2 trillion exceeded the UK GDP for the first time in history [Hymans Robertson 2015]. The 2015 annual joint report by the Pensions Regulator and the Pension Protection Fund [The Pensions Regulator and Pension Protection Fund 2015] demonstrates the impact of uncertainty on pension funding and provides a review of the dramatic changes to pension scheme funding in the UK over the past 10 years. The report cites a greater awareness of longevity risks and the recession following the financial crisis, as key contributors to the current issues with funding. The report observes that the aggregate funding ratio in March 2015 was 84% with a deficit of £244 billion compared with 97% cover and a deficit of £23 billion 10 years before.

The detrimental impact of government decisions is not limited to times of financial crisis. In 1997 the Labour government removed the tax relief on dividend payments to pension schemes. This was a hugely unpopular decision, described in the media as a 'raid' on pensions and blamed for causing financial instability and contributing to many closures in the following years. Recently, the taxation regime of pensions in the UK has returned to the policy agenda. It was proposed in a government consultation to alter the taxation of UK pensions to a tax on payment into pensions, with tax relief on accumulation, and also when the pension is paid out (known as 'taxed, exempt, exempt') rather than the current 'exempt, exempt, taxed' system [HM Treasury 2015]. The decision was not adopted in the March 2016 budget, possibly due to the negative public sentiment, although it has not formally been abandoned. The consultation document claimed that the gross cost of pensions tax relief cost the government £50 billion in 2013-2014; the proposed new taxation system intended to increase revenue from pensions taxation to reduce the deficit and alleviate the pressure on public finances. However, the proposals have met with criticism from many in the industry, notably a former Pensions Minister who sees the proposals as damaging confidence in pensions amongst the working population and as seeing pensions as a 'convenient pot for cash strapped Chancellors' [Webb 2016].

From the perspective of external influence upon pensions, the EU itself has contributed to the detrimental impact on pensions under the austerity measures introduced to combat the effects of the financial crisis. The consequential impact upon employee protection under the labour law systems amongst EU Member States has been the subject of academic criticism. Barnard's analysis of austerity measures

imposed at an EU level observes that the pension monitoring system in the Euro Plus Pact encourages a shift away from defined benefit to money purchase pension schemes [Barnard 2012]. She is critical of the impact upon labour protection by the direction of EU policy following the financial crisis and identifies a trend towards deregulation, which she describes as a threat to national labour law that is “driven largely by the EU”. Ashiagbor [2013] observes that the economic crisis has accelerated the trend of deregulation of labour law standards in the pursuit of a more flexible workforce which is proposed as an answer to improving access to work following the crisis. Ashiagbor notes that the financial crisis has had a ‘devastating impact on labour markets globally, and on livelihoods and incomes of ordinary working people’ and identifies the need for supranational institutions such as the ILO and the European Commission as ‘significant voices’ which can help maintain social labour standards where existing national systems have met with difficulty. Clark and Urwin [2010] have argued for the importance of innovative decision making in pensions in times of economic crisis and observed that due to the size of funded schemes in certain countries such as the UK, they have effectively become the ‘lender of last resort’ in times of financial crisis. Whilst innovative national solutions are welcome, increased engagement between national stakeholders and the current EU framework would improve confidence of employees in occupational pension provision. Further developing of the current EU approach would build upon the benefits of shared international experience supported by the legal framework of EU law.

### 3. The potential of the EU system

The European Commission already seeks to create a ‘more harmonised and robust’ [European Commission Memorandum 2014] framework of regulation for occupational pensions, motivated by a desire to encourage funded arrangements amongst certain Member States and to facilitate cross border provision. However, as Guardiancich and Natali observe, institutional differences and national social and labour law systems present significant barriers to co-ordinating a policy response to occupational pension arrangements throughout Europe [Guardiancich, Natali 2012]. The largest UK body representing pension funds, the Pensions and Lifetime Savings Association (formerly the NAPF), has observed that the UK has approximately 60% of Europe’s defined benefit liabilities and suggests that the EU is particularly useful in relation to best practice guidelines and warns against any increase in regulatory scope [HM Treasury Review... 2013]. Despite resistance to recognising an increased role for the EU in UK occupational pensions, it is suggested that the economic crisis demands an international response to safeguarding standards of pension protection and that the EU is best placed to fulfil this role due to its unique institutional structure. The EU provides not only a forum for sharing ideas (through the Open Method of Co-ordination) but legislative initiative (Primary and Secondary legislation) and enforcement (through the Court of Justice). It is not proposed that the EU is given in-

creased regulatory control; it is suggested that national stakeholders are compelled to engage with key principles which underlie EU legislation and are given duties of enforcement and discretion. If IORP II and the pensions OMC are properly engaged with by national stakeholders, they could provide a basis for further agreements on minimum protection on pensions. Meaningful change will not be brought about by more legislation alone, but by a systemic change to the current interaction between the stakeholders in pensions.

The Lisbon Strategy that launched in 2000 and is currently embodied in the Europe 2020 strategy, has led to the OMC in pensions, which Hennessy observes may have helped to share knowledge amongst Member States but lacks the binding nature of a directive [Hennessy 2014]. The positive aspects of the pensions OMC highlight the benefits of sharing information at the international level. However, participation should not just take the form of information sharing, instead national stakeholders should take a greater and more integrated role in enforcement of key principles of protection for scheme members. The EU legislative institutions have the full support of the Court of Justice, described as a 'one of the most powerful high courts in the world' [Stone Sweet 2011]. Due to the supremacy of EU law over national law (Case 6/64, 1964, Case 26/62, 1963) the influence of the Court of Justice has had direct influence upon several areas of occupational pension policy in the UK, for example in relation to the requirement to equalise retirement ages for male and female members (Case C-262/88, 1990). Judicial decisions reached under the Preliminary Reference Procedure (Article 267 *Treaty on the Functioning of the European Union*) do permit interested parties to submit opinions, however, consultation that accompanies legislative initiatives permits greater involvement in legislation. One such piece of legislation is the IORP Directive.

The passage of IORP II has not been smooth from a UK perspective, mostly due to the proposed 'holistic balance sheet' which, according to the UK, would have led to funding requirements for pension funds similar to the Solvency II minimum capital requirements imposed in the insurance industry. It was argued that such amendments would have been inappropriate for funded defined benefit pensions in the UK, which often operate with significant deficits. Concerns about the potential impact of the proposed funding standard in a funded defined benefit pensions environment such as in the UK and the Netherlands, encouraged several interested parties including interest groups as diverse as Business Europe and the European Trade Union Confederation to join together to oppose the 'holistic balance sheet' and to take an active interest in the creation of IORP II [*Joint Statement Employer ...* 2012]. The 'holistic balance sheet' has now been removed from the draft IORP II which is now less controversial for the UK, focussing instead on governance issues and emphasises the 'minimum harmonization' intentions of the directive (Recital 2a). The proposed IORP II will seek to introduce higher standards of trustee knowledge and understanding as well as standardise information requirements for scheme members. Building upon IORP II, there are now clear principles which national stakeholders could play an important role in promoting.

## 4. Interaction with the national framework

There is much potential for EU influence upon key stakeholders in the UK pensions system. The positions of trustees, employers and national policy are briefly considered below in relation to initiatives that have been put forward in the IORP II. Rather than seeing such provisions as simply stating the current position, the stakeholders should actively engage in a two way process with the EU institutions in order to promote principles of good practice.

### 4.1. Trustees

The Pensions Regulator currently promotes trustee knowledge and understanding in addition to the provision of comprehensive statements to scheme members, which already goes some way to the intended IORP II requirements. The IORP II Article 23 requires trustees to fulfil the ‘fit and proper’ requirements, which includes the need for the collective trustee body to have adequate qualifications, knowledge and experience. Improved trustee standards have been advocated by Clark and Urwin [2010] and the focus upon governance and transparency in the IORP II should be adopted as a means of engaging with scheme members, with greater control given to national stakeholders to further the principle of transparency and improved governance. This is similar to recommendations from the OECD in the wake of the financial crisis [Keeley and Love 2010] as well as existing requirements under UK statutes governing trust law, for example the *Trustee Act 2000* section 1 requires that a trustee: ‘...must exercise such care and skill as is reasonable in the circumstances...having regard in particular to any special knowledge or experience that he has...’ and pensions law where the *Pensions Act 2004* section 247 requires that a trustee of a pension scheme ‘...must have appropriate knowledge and understanding of the law relating to pensions and trusts...’. It could be argued that the requirements will make it more difficult for member nominated trustees to take positions on trustee boards, and that further training would be cumbersome. However, the IORP II requirements should be seen as an opportunity to improve the standards of trustee training, as a minimum harmonising directive. It is a decision for the UK, including all stakeholders, to determine how the requirements should be fulfilled.

### 4.2. Employers

The role of employers as sponsors of occupational schemes could be improved through the existing framework in line with the extensive literature on corporate social responsibility. *The Companies Act 2006* section 172 (1) requires company directors to take decisions with regard to the interests of their employees and the likely consequences of any decision in the long term. The diverse literature on corporate social responsibility has often focused upon the need for a more ethical approach to the duties of directors and the conduct of companies. One such example can be seen

in the literature arguing that theories developed from Kant's moral framework, particularly the notion of 'imperfect duties' and the concept of altruistic 'beneficence' could lead to a corporate culture that considers the wider community within which it operates [e.g. Mansell 2013]. The call for enhanced corporate engagement with the wider community, could operate with the existing trustees of the pension fund and the IORP II principles of enhanced governance in scheme management to provide a higher standard of protection for scheme members. For example the IORP II has significant detailed requirements in Articles 38 – 58 concerning the information that must be given to members and prospective members. In order to gain the confidence of UK business, the IORP II could provide the opportunity for sponsoring employers to collaborate with the Pensions Regulator and its EU counterparts through European Insurance and Occupational Pensions Authority to further the governance objectives and improve protection for scheme members.

### *4.3. National policy*

Pemberton observes that pension reform in the UK, Germany and Italy has been 'piecemeal and erratic' and often driven by the 'short term electoral calculations of politicians' [Pemberton, Thane, Whiteside 2006]. The presence of an EU legislator is a means of focussing on the key goals in pensions and avoiding the temptation for governments to misuse pension arrangements for financial gain. On a national stage, intervention from the World Bank, initially with the report in 1994 on Averting the Old Age Crisis, led to the establishment of the three pillars in pensions and promoted the idea that the first pillar of state pension provision should decrease and private pensions increase [Blackburn 2002]. Significant amendments to pensions systems followed [Daykin 2006] and government concern for financing pensions saw further moves away from more generous state provision in countries which had typically provided earnings related pensions such as Germany and Sweden [Hinrichs 2006]. Following the recent financial crisis, severe amendments were seen in countries which typically provided more generous state pensions such as Italy [Scherman 2012] and Greece [Tinios 2012]. The IORP II states at recital 2a that it, '...does not concern issues of national social, labour, tax and contract law, nor the adequacy of pension provision in Member States...'. Concerns over how difficult it may be to apply the directive should not outweigh the positive aspects of what could be achieved through the benefit of supranational guiding legislation that seeks to overcome national political hurdles and focus on the key issues.

## **5. Conclusions**

It is suggested that the EU is in a unique position to enhance the protection for pension scheme members across Member States using its existing structures within defined parameters. The detail of policy decisions should stay with national parliaments but the level of protection for scheme members could be increased through

engagement with national stakeholders by giving them an enhanced role in initiatives such as IORP II and by acting as a check on the reach of national governments. The influence upon national governments may be encouraged by EU wide legislative initiatives but is best achieved through having a judicial dimension such as the Court of Justice of the European Union.

Rather than being intimidated by the detail and requirements of the EU legislation, the key stakeholders such as the regulators and sponsoring employers, should be given greater roles in IORP II, with discretion over the implementation of the principles and power to regulate and enforce compliance. The unique nature of the EU means that proposed increase of the role of the EU should operate around broad basic principles founded upon primary law in existing Treaty provisions, secondary law such as the IORP II and 'soft law' such as the pensions OMC. A recent publication from DG Employment, Social Affairs and Inclusion refers to a 'cultural revolution' being necessary if EU countries are to ensure adequate pensions [*Social Agenda 43...* 2016]. In times of significant financial uncertainty, governments should be forced to look outside of their own national priorities to retain focus upon the long term needs of pension provision, both with regard to state sponsored and legislation affecting employer sponsored occupational pensions. As key principles put forward by IORP II are already in harmony with the national regulatory focus in the UK, rather than taking an isolationist, confrontational approach to EU legislation, national stakeholders should seek to interpret and engage with the principles. However, in order to do so, EU structure should take action to promote engagement with national stakeholders and provide devolved control to the enforcement of the objectives under IORP II. It may, however, be too late for the UK as the negotiations to leave the EU begin, although there is significant uncertainty as to how any UK relationship with the EU may look in the future. It would be wise to remember the potential of EU level support and protection for citizens against national decisions taken in times of financial uncertainty.

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## *Ochrona uczestników planów emerytalnych w czasach kryzysu finansowego: analiza kompetencji ponadnarodowych*

**Streszczenie.** Pracownicze programy emerytalne są szczególnie podatne na negatywne konsekwencje, zarówno ekonomiczne i polityczne, wynikające z globalnej finansowej niepewności. Jest to szczególnie widoczne w przypadku takich krajów jak Wielka Brytania, gdzie uwarunkowania historyczne doprowadziły do przewagi występowania pracowniczych programów emerytalnych o zdefiniowanym świadczeniu, które w wielu przypadkach odnotowują obecnie ogromny deficyt. Zasadniczo argumentuje się, że indywidualni uczestnicy planów emerytalnych korzystają z ponadnarodowych regulacji emerytur pracowniczych oraz, że Unia Europejska jest najlepiej umocowana, by takie wsparcie zapewnić. Jednocześnie twierdzi się, że rola Unii Europejskiej w zakresie emerytur może być zwiększona. Kluczowe zagadnienia są szczególnie istotne dla członków pracowniczych planów emerytalnych w Wielkiej Brytanii w rezultacie podjęcia decyzji w referendum 23 czerwca 2016 r. o opuszczeniu Unii Europejskiej.

**Słowa kluczowe:** Unia Europejska, emerytury pracownicze, kryzys finansowy.

**Kody JEL:** G22, H55, J26.