Bandwagon

The BWCI Group Newsletter

BWCI

Quarter 1 - 2016

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Guernsey Secondary Pensions

Welcome to the first edition of Bandwagon in 2016.

The first full week of the New Year saw the release of Guernsey's Social Security Department's policy letter on the introduction of a Secondary Pension system.

We welcome the high level proposals and have provided a summary of our current understanding of the key proposals in the centre pages of this edition of Bandwagon.

In addition, we are holding a free seminar at 3:30pm on 4 February at Les Cotils to look what the proposals might meant for employers and their staff. It will also provide an opportunity for employers and trustees to share their initial reactions to the proposals.

To request a place please email seminars@bwcigroup.com with the following details:

- The names of the people wishing to attend
- The name of your organisation

Secondary Pensions Seminar

An overview of the Social Security Department's proposals

What is proposed?
What does it mean for you and your business?

Guest Speaker
Niki Cleal, Independent Consultant

BWCI Speaker
John Martin - Partner

Thursday 4 February - 3:30pm - Les Cotils, L'Hyvreuse, St Peter Port

BWCI's 2016 Bursary Launched

Isobel Sanders
BWCI's 2015 Bursary recipient

BWCI's student bursary scheme is now in its 10th year and we are now inviting applications for our 2016 bursary. We would particularly like to hear from students studying for degrees in maths or economics, or degrees with some mathematical content.

Since its launch back in 2007, we have supported 10 local university students. As well as providing financial support, our bursary students participate in a structured training programme during their summer vacations, for the duration of their course.

The closing dates for entries is Friday 4 March. For further details and an application form, please go to http://www.bwcigroup.com/bursary/

Bursary Requirements

The three main requirements are that the applicants should:

- Have local residential qualifications
- Not be receiving a bursary from any other company at the same time
- Have two A grades at AS level, one of which must be in maths

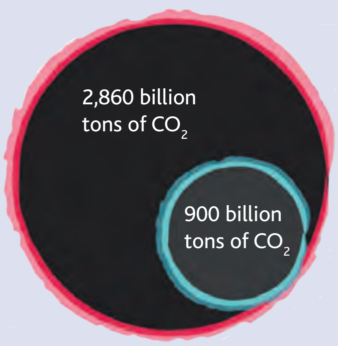
Over to you

We try to cover a range of topical employee benefits, insurance and investment issues in Bandwagon. If there is a particular issue you would like us to include, please email us at bandwagon@bwcigroup.com.

Fossil Fuels

"buried treasure that has to stay buried"
Mark Colton

Carbon Bubble
Emissions from burning all known reserves of coal, oil and natural gas



Remaining carbon budget
This is how much CO_2 can be emitted until 2050 and still give a reasonable chance of staying below 2 degrees Celcius of global warming

Source: Carbon Tracker Initiative

The new enemy

The Earth is currently in a geologically cool interglacial period but you wouldn't know it. Global warming dominates the headlines. The treasure troves of coal, gas and oil that fuelled the industrial revolution came with unwelcome side effects. Their continued use is projected to make catastrophic climate change unavoidable.

The companies being painted as the bad guys are the miners and refiners. However only about 10%- 30% of CO_2 is released in the mining of fossil fuels; the rest comes from consumers burning it. That's you and me: driving; travelling by aeroplane and train; heating and lighting our homes and workplaces. We are our own worst enemy.

Stranded assets

The clock's ticking in more ways than one. We know how much fossil fuel is left underground, and we know how much more can be burnt before we risk irreversible climate change. The calculations have been done (see chart). Most of it has to stay underground. "Stranded assets" is the new jargon for buried treasure that has to stay buried.

The investment case

Unfortunately buried treasure that has to stay buried isn't much use, especially to the companies that own it. So whatever your ethical position on miner and refiner companies, you might conclude they are overvalued and currently poor investments. Many ethical investors are divesting themselves of these assets, which puts some downward pressure on prices.

Ethics

The ethics are problematic. Fossil fuels do not fall easily into the "sin stock" category. For example, despite what marketeers may tell us, alcohol and tobacco are not essential to a healthy society. The same cannot be said of heating, light and power. Arguably the only large-scale, credible current alternative to fossil fuels is nuclear power, which comes with uncomfortable side effects of its own, doubly unnerving in an age of international terrorism.

Politics

The world currently looks to its politicians to provide answers. So far this has resulted in pledges, but no legally binding commitments. The stalling of China's economy, which actually helps curb CO_2 emissions, is creating concerns over global growth. A political solution seems unlikely.

Science

Some are suggesting that we are looking in the wrong place for a solution and that science is the white knight coming to our rescue. A recent article in the Financial Times pointed out that curbing CO_2 emissions is only half the answer. A credible alternative is needed to supply the world's energy needs.

Solar

The biggest nuclear fusion reactor you and I will ever see is the sun. It produces enough power in one second to cover the Earth's annual energy needs half a million times over. Even the small fraction that reaches the Earth provides a year's worth of our total energy needs in 1¼ hours. We just can't capture and store it very well, or cost-effectively. But that is changing. Better and cheaper solar panels, better and cheaper batteries. These are already in development, and for those wanting to dig deeper, and tolerant of marketing, I offer www.teslamotors.com/en_GB/powerwall. I can't vouch for the figures, but it is clear that a real world solution is probably going to look similar to this.

For those who can't be bothered to access it, the link demonstrates the practicability of large scale investment in solar panels, electric cars and super-efficient batteries. Here's how we might get transport, heating and lighting, without the gloomy cloud of CO_2.

The investment consequences

For investors with large segregated portfolios this offers a positive to offset the negative, and a way to view energy sector investment more broadly. Whether you are an ethical investor or just one who is wary of the future for miners and refiners, a programme of disinvestment has serious consequences, not least because of the significant proportion of global stock markets represented by fossil fuel companies. Such companies also tend to be good dividend payers, and popular with pension and charity funds.

At BWCI we are using our forward thinking and extensive experience of pension fund investment to produce strategies that tackle these issues.

Guernsey Secondary Pensions

"every employer would need to automatically enrol their staff"
Michelle Galpin

Early January 2016 saw the publication of the long-awaited proposals for the introduction of a secondary pensions system in Guernsey. The proposals, which are scheduled to be debated by the States at their February meeting, would provide a retirement income in addition to the existing old age pension.

How we got here

It was back in 2013 that the Treasury and Resources and Social Security Departments first launched a joint consultation, as part of its wide-ranging review of personal tax, pensions and benefits.

"Ensuring private pension provision" was subsequently identified as one of the tools available to mitigate the financial strain on the States of the effect of Guernsey's ageing population.

Secondary Private Pension Provision

In August 2015 the Social Security Department launched its own consultation on secondary pensions; views were invited on whether a secondary pension system be introduced, the extent to which it should be compulsory and how it should be delivered.

This consultation closed in October 2015 and the 222 responses have formed the basis of the current proposals.

What is proposed?

At 68 pages, the policy letter and its supporting appendices provide the background to why the system is being proposed, as well as a summary of the feedback from the public consultation. The main proposals are summarised in the box (right). In this article we focus on who would be affected and the costs involved.

The key proposal is that from 2020 every employer would need to automatically enrol their staff into either the Secondary Pension, or a "qualifying" pension arrangement.

Who's affected?

To keep things simple, every employee paying Social Security contributions would be included. In 2016 terms, this is everyone who is earning more than the Lower Earnings Limit of £6,916pa. Unlike the UK, no minimum age limit is proposed, so all employees under State pension age (currently age 65, but increasing to age 70 by 2049) would need to be automatically enrolled.

Employees have a choice

Whilst staff would be automatically enrolled, the system is described as "semi-compulsory" as employees would have the choice to opt out. However, their employer would need to re-enrol them again every 2 years. This is similar to the approach taken in the UK, except that re-enrolment is only once every three years.

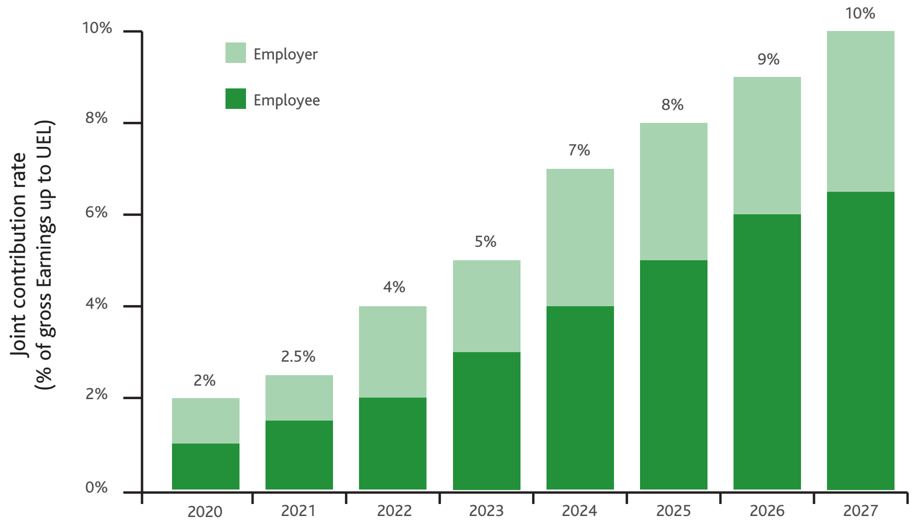
How much will it cost?

Contributions would be calculated as a percentage of "Gross Earnings" up to the Upper Earnings Limit (£137,592 in 2016).
The long term contribution rates proposed are 3.5% for the employer and 6.5% for the employee. However, the employer would only have to contribute for employees who had not opted out of the secondary pension system. In 2016 terms, the maximum employer contribution for an individual earning in excess of the Upper Earnings Limit would be £4,816pa; the maximum employee contribution would be £8,943pa.

Phased contributions

It is recognised that these contribution rates could have a significant impact on the finances of both employers and employees; for this reason it is proposed that the contributions be phased in over 7 years. Details of how the phasing in would work is illustrated in the chart below.

Phased Employer and Employee Contributions



Conclusions

Guernsey is not alone in tackling the financial challenges of an ageing population. Encouraging people to take more responsibility for their own financial circumstances in later life is a key part of the strategy to address the problem.

The UK began its auto enrolment journey in 2012 and every employer will have had to have implemented auto enrolment by 2018. Guernsey is already several years behind, with the Secondary Pension system not scheduled to be introduced until 2020.

However, this delay has provided an opportunity for Guernsey to take stock of what the main problems have been in the UK and seek to avoid them, with a simpler system more appropriate to its working age population of around 43,000.

Assuming that the States approve the proposals in principle at their February meeting, we will be considering different aspects of the proposals in more depth in subsequent editions of Bandwagon.

Summary of Proposals

- A new Secondary Pension ("SP") system would be established in 2020. This would be in addition to the existing Old Age Pension arrangements.
- All employers would be required to automatically enrol their staff, either into the SP or a "qualifying pension scheme".
- Employees would have the right to opt out of automatic enrolment, but would have to be re-enrolled by their employer every two years (but could then opt out again).
- Except where an employee had opted out, the employer and the employee would be legally required to contribute to the scheme.
- The joint employer/employee contribution rate would be split roughly 1/3rd employer and 2/3rds employee; the proposed long-term employer and employee rates are 3.5% and 6.5% of gross salary respectively.
- Employees could pay in additional contributions, but this would not affect the amount the employer was required to pay.
- It would be illegal for an employer to offer employees inducements to opt out.
- Self-employed and non-employed people who are paying social security contributions would be automatically enrolled, but could opt out.
- Non-employed people who are not paying social security contributions could opt in to the SP.
- Parents or other relatives would be able to open a SP account for their dependants on an opt-in basis, provided that they were willing to contribute to the scheme.
- The SP would provide benefits on a money-purchase basis, with an individual's "pension pot" forming part of their estate on death either before or after retirement.
- Contributions to the SP would be collected through the Social Security system, but the administration and investment of the SP would be contracted to another party (to be appointed by competitive tender).

Timetable

January 2016
Proposals published

February 2016
States debate high level proposals

December 2017
Deadline for detailed proposals to States

2020
Launch of automatic enrolment and Secondary Pensions

2027
Phasing in employer and employee contribution rates complete

Cashing In annuities

"Valuing annuities will be difficult"

Ian Morris

Jargon buster

Annuity
This is a financial contract in which an insurance company guarantees to pay a regular income stream for the lifetime of an individual. The payments may be fixed or increase in some way.

FCA
The Financial Conduct Authority is the regulator of the financial services industry in the UK

Pension Wise
A free and impartial government service providing guidance on the options for members of defined contribution pension arrangements

Unauthorised payment charge
The penalty imposed by HM Revenue & Customs on unauthorised payments from a pension arrangement.

Since 6 April 2015 individuals with UK pension savings have had more options at retirement. In particular, there is no longer a requirement to purchase an annuity; instead funds can be withdrawn, as needed, but are subject to tax at a person's marginal rate.

The UK government has recently published details of how it is proposing to extend similar flexibility to pensioners, by allowing annuities to be sold.

A key change will be the removal of the unauthorised payment tax charge of up to 55% (or even 70%) that has hitherto been designed to deter annuity holders from assigning their annuity. From April 2017 it is proposed that annuities will be able to be exchanged for cash, with the proceeds taxable at the individual's marginal rate.

It is estimated that there are around 5 million people with an annuity. However the changes will not generally cover annuities from occupational schemes, unless the trustees have assigned the annuity to the member.

Protecting annuitants

The remit of Pension Wise will be expanded to provide support to annuitants. In addition, those with an annuity worth more than a minimum level (yet to be determined) will be required to take financial advice before they can sell their annuity.

Even with this additional support, there are concerns about the potential for aggressive practices encouraging pensioners to sell their annuities. Therefore, it is proposed that at least one party involved in the transaction will have to be regulated by the Financial Conduct Authority ("FCA").

What's it worth?

Pensioners may find it difficult to assess the value of their annuity. If they could obtain a number of quotes this would provide a range for the perceived market value of the annuity. However, it could be quite expensive to obtain quotations; the annuitant may have to provide detailed medical information, which each provider would then need to assess, to consider the annuitant's potential life expectancy.

What about dependants?

If an annuity has been structured to provide a contingent income to a dependant there is a concern that the dependant's interests may not be protected. The FCA are to be asked to consider whether appropriate rules are needed in such cases.

Unintended consequences

Pensioners in receipt of means tested benefits or social care benefits need to be aware of the full implications if they choose to sell their annuity. This is because their State benefits may be affected by the balance between capital held and income received. The existing rules, which limit the ability to structure savings to maximise means tested benefits, may be sufficient to cover such issues but may need to be reviewed.

Issues for insurers

Implementing the new flexibility will be a significant challenge for insurers. While they will not be compelled to offer it to annuitants, there may be public pressure to do so.

Valuing annuities will be difficult in many cases, as they will need to allow for the health status of annuitants, otherwise they would be at risk of pensioners with short life expectancies seeking to cash in their benefits for a more valuable lump sum.

For small annuities the cost of a medical review could be disproportionate. However, it is unlikely that the insurer would be able to willing to offer cash in lieu of pension without some form of health assessment.

Local implications

The proposals only relate to the UK. Annuitants in the Channel Islands and the Isle of Man would not be affected, unless their annuity arises in the UK.

Of course the Crown Dependencies could decide to offer similar flexibility to annuitants in their jurisdictions. As the size of markets in each island is much smaller than the UK, it seems unlikely that many (if any) insurers would want to go down this route.

It remains to be seen how the UK market develops, but we would anticipate fewer changes in the Channel Islands and the Isle of Man; possibly no change at all.

New Guernsey RATS Rules

"three different investment approaches"
Debra Smith

Following consultation and the resolution of a "fatal flaw", the final Retirement Annuity Trust Scheme Rules, 2015 were published by the Guernsey Financial Services Commission ("the Commission") on 30 November 2015.

These new rules came into operation on 31 December 2015 and apply to licensed fiduciaries and licensed insurance intermediaries. They replace the previous rules which were published in 2010 and amended in 2013.

So how do these latest rules compare with the previous ones? In this article we highlight the key similarities and differences.

Advertising and Promotion

As currently, advertising of RATS and their investments must not be false, misleading, deceptive or inaccurate.

Suitability of Investments

The most significant change is the introduction of three different investment approaches, as summarised in the box below.

When establishing a RATS or admitting a member, trustees must document an analysis of the member's circumstances, the investment approach taken and the reasons why the proposed RATS is considered suitable. However, the requirement to provide a specified statement on investment and mortality risks has been removed.

Gearing

In line with the 2010 rules, before a trustee borrows money, the member must be provided with a statement explaining the risks of gearing. The member must sign this to indicate their understanding.

The new rules have introduced a further requirement and, in addition to the member declaration, trustees now have to "ensure the member understands the consequences of the gearing". It is unusual to have a regulation that requires one party to ensure the understanding of another and, to date, the Commission have not provided any guidance as to how they expect trustees to comply with this.

Reporting

The reporting requirement is unchanged and members must continue to be sent an annual benefit statement and copies of any statements prepared by other parties relating to the investment performance of their RATS (eg investment manager reports).

RATS Drawdown

As currently, drawdown payments need to be appropriate. However, the explicit requirement for "realistic assumptions" to be used has been removed.

The new rules allow for the flexible payment of funds which have been transferred from UK pension arrangements. This is to reflect the recent changes to the tax legislation which we summarised in the previous edition of Bandwagon. However, the tax legislation permits flexibility for funds transferred in from any jurisdiction which has a more flexible regime. It is therefore a surprise that the RATS rules have restricted this flexibility to UK funds only.

Fee disclosure

As currently, fees must be disclosed to the member. However, the requirements have changed slightly. There is now a concession that, where the specific amount of any fees is not known, the basis of calculation can be provided instead. However the previous exemption from disclosing fees, such as stockbrokers' share dealing fees which are charged at arm's length, has been removed.

Transfers from Defined Benefit schemes

The requirement to obtain a "transfer value analysis report" when transferring funds of more than £30,000 from a defined benefit pension scheme to a RATS remains. However, similar to the new gearing requirement, the trustee must now "ensure that the member understands this report and the member must sign a declaration of their understanding of the consequences of the transfer decision".

Compliance with Income Tax conditions

The RATS rules continue to sit alongside the requirements of the Guernsey Income Tax Office and licensed trustees need to comply with both.

RATS Investment Approaches

Traditional
The trustees decide upon the investments, which may or may not follow a recommendation from the member.

Self-invested
The member self-directs the investments and disclaims the trustee of any responsibility for the suitability of the investments and investment strategy. This approach requires a signed certification by the member.

Investments-advised
Investments are only made into financial products detailed in Annex A to the 2015 RATS Rules (eg cash, corporate bonds, shares listed on recognised exchanges) and the investment is made on the advice of a licensed financial adviser.

Karen joins international committee

Karen Jolly

We are pleased to announce that BWCI's Group Company Secretary, Karen Jolly, has been elected to the UKRIAT committee, an international committee of the Institute of Chartered Secretaries and Administrators (ICSA) with effect from 1 January 2016.

The committee is the ICSA governing body for the UK, Republic of Ireland and Associated Territories (UKRIAT). It covers around 10,000 members, including those in Guernsey, Jersey and the Isle of Man.

Karen joined BWCI in 2000 and was awarded an MSc in Corporate Governance in 2007. In 2011 she was elected as Chairperson of the local branch of ICSA, a position that she held for 2 years.

Karen said *"I am looking forward to the challenges of this role. In addition, it will enable me to represent local interests within our governing body."*

Next Family Concert

Put on your superhero suits, capes and masks for an afternoon of sensational sounds with plenty of fun and audience participation at the next BWCI Camerata Series Family Concert.

Featuring the iconic superhero theme tunes from Batman, Spiderman, The Incredibles and Superman, the action-packed programme promises to show off the Guernsey Camerata orchestra's super strength, super speed and super sound!

If the number of entries to this year's competition to design the concert poster is anything to go by, we expect the Superhero theme to be extremely popular. With almost 70 entries, choosing a winner was harder than ever. Congratulations go to 17 year old Elliott Cockett from Elizabeth College for his winning superhero design.

All the action takes place 2.30pm on Sunday 7 February at St James. See you there!

Diary dates

4 February	BWCI Secondary Pensions Seminar
7 February	BWCI Camerata Concert Series - Family Concert
11 February	Winner of the BWCI Innovation Award announced
4 March	Closing date for 2016 BWCI Bursary applications
8 March	BWCI Inter-Island Junior Maths Team Challenge
23/24 July	BWCI Mini Soccer Festival

Front cover image courtesy of VisitGuernsey

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