Bandwagon

The BWCI Group Newsletter

BWCI

Quarter 4 - 2018

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Fund raising in the Hel(l)vetia Challenge

Guernsey Pensions Regulation in Force

30 September 2018

Pension regulation was first introduced in Guernsey on 30 June 2017. However, in view of the speed at which it was implemented, there was a transitional period up to 30 September 2018 before full compliance was required. With the end of the phasing in period, pensions legislation is now fully in force.

We asked Stephen Ainsworth, the Chairman of the Guernsey Association of Pension Providers and BWCI Senior Partner, for his reflections on the progress made over the last 15 months. He said:

"It has certainly been a busy time for pension providers in Guernsey. Not only have they had pension regulation to plan for, but also the implementation of the Common Reporting Standard and GDPR. There's also the prospect of the introduction of the new Anti-Money Laundering Handbook just around the corner too.

Although many of the principles within the new requirements were already in place as good practice, applying the detailed requirements and evidencing compliance has created a substantial amount of work for pension providers generally".

The introduction of a regulatory framework for pensions has been well received, both locally and within the wider international pensions industry. In particular, it has been helpful in attracting new international pensions business to Guernsey.

Although there are no published statistics yet, anecdotal evidence suggests that regulation is having a strong positive impact and we anticipate that an update to the pension regulations to reflect industry feedback will be published in the near future.

Regulatory compliance is ongoing and now part of "business as usual" for Guernsey pension providers. However the industry recognises the importance of continuing to work closely with the Commission to ensure that the new regulatory regime is both proportionate and practical. In addition, licensees will need to ensure that they continue to comply with the requirements, both for their current schemes and any new schemes established in the future.

Regulation training

We have had a number of requests to provide training on the ongoing practical application of the new Guernsey Pension Regulations. We have developed a training course that can be tailored to the specific needs of an organisation's team working in this area.

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Protecting Scheme Assets

"small errors can result in significant refunds"

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Background

Previous articles have highlighted the importance of monitoring investment managers' performance and carrying out a review of fees to ensure that they represent value for money. However other checks, such as ensuring the correct investment management fees have been invoiced, or that a change in investment strategy has been implemented correctly could be overlooked. Due to the size of pension scheme assets, even small errors can result in significant refunds being due if an error is identified.

Calculating Fees

The fees charged by an investment manager are not always straightforward. There may be a fixed fee element, together with a variable component. This is usually expressed as a percentage of the Assets Under Management (AUM). Complexity starts to creep in as these percentages vary depending on the circumstances. For example, by total level of AUM, types of investment held, services provided, level of investment performance and whether in-house or external funds are used. As well as increasing the complexity of calculation, it also increases the risk that an error in the fee calculation slips through unnoticed.

Common errors

There are a number of different ways in which fee errors could occur, such as:

- increasing asset values
- changes in asset allocation
- application of fee discounts

What can Trustees do?

A good starting point is to consider scheme governance arrangements. Do trustees carry out an annual review of fees invoiced, which would help identify any issues? We have carried out several recent fee reviews which resulted in schemes receiving refunds totalling around £50,000 for a single quarter. What is perhaps of most concern is that some errors had gone unnoticed for some considerable time and spanned more than 10 years.

New Fee Term Eligibility

The assets of many pension schemes are likely to have grown considerably since the initial fee terms were agreed, perhaps many years ago. If the investment manager applies a tiered rate fee structure the scheme's assets may have passed these thresholds unnoticed. Missing out on the lower fee rates, as asset values increase, means that schemes are potentially paying more fees than they should be for each future year until the error is spotted.

Special deals

It is fairly common for a small scheme to negotiate the same favourable fee structure deal where it has a link with a larger scheme within the same group. Anything that is a "non-standard" arrangement increases the risk of an error occurring. This could arise due to a failure of internal communication somewhere along the line. A similar situation may arise if new clients are being offered improved introductory terms relative to existing clients. In addition, where new clients are being offered better terms than existing clients, it may be advantageous for existing clients to update their fee agreements to benefit from lower fees.

There are other areas where schemes might inadvertently suffer a financial loss. These are most likely to occur when something is changing, such a restructuring of the portfolio.

Investment Transactions

When trustees wish to switch to a new investment strategy an investment manager is instructed to make the change on a specified date. The late, inaccurate or even missed application of instructions can result in the scheme being invested in the wrong assets for a period. This could adversely affect the investment performance. Trustees can minimise this risk by checking that the transactions were carried out correctly. Where any shortcomings are discovered, investment managers must rectify the situation by correcting the asset allocation and making good any shortfall in the asset value. Spotting these errors early is important in reducing the level of risk to which the scheme is exposed.

Out-of-Market Risk

Trustees should also be aware of the risks associated with transferring funds between investment managers. Often this involves selling the assets held by one manager and reinvesting them with another. This introduces a period where the assets are held in cash (out-of-market). The risk is that there is a significant market movement during this period and a scheme misses out on potential investment gains. The risk can be reduced by using in specie transfers and/or using pre-investment (a loan facility offered by some investment managers). This enables investment in the target assets on the same day that existing holdings are liquidated.

Conclusions

Undetected errors in fee calculations and unnecessary out-of-market risk could potentially result in a significant financial loss to a scheme. However, it is a relatively simple and inexpensive process to put in place measures to safeguard a scheme's assets and strengthen its governance arrangements.

Channel Island Budgets: Pension changes

"1,050 individuals will see their allowances reduced"

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Guernsey and Jersey both released their 2019 budget proposals on 9 October. These will be debated in the relevant States later in the year.

Each island is proposing some changes that will affect pensions, although Guernsey's list is rather longer than Jersey's!

Guernsey budget

Aspect	Detail
Tax-free element of lump sums	After age 50 a person may take a cash lump sum of up to 30% of their fund value; the lump sum is tax-free up to a monetary limit. The 2018 limit is £194,000 and historically has been set by reference to Civil Service pay scales. This linkage caused problems this year as the pay award had not been agreed at the start of the year and a retrospective increase had to be applied. **To avoid this going forward, it is proposed that the limit will in future be set annually as part of the Budget process; an increase in the limit to £198,000 is proposed for 2019.**
Definition of acceptable pension contribution for tax relief	**Guidance on what pension contributions will be eligible for tax relief will be issued and applicable from 2019.** It is proposed that: ■ a monetary amount must actually be paid into a scheme to be eligible for tax relief; in specie contributions will not receive tax relief ■ transfers from other pension arrangements are not contributions for tax purposes ■ contributions that derive from benefit payments from approved pension schemes will not receive tax relief

Triviality provisions	**An increase in triviality limits is proposed** as follows:
	■ increasing the limit from £30,000 to £50,000 for members aged 50 or over
	■ introducing triviality limits for funds in drawdown where the fund is less than:
	    ▪ £50,000; or
	    ▪ £100,000 and the individual has a guaranteed minimum retirement income of £20,000 pa
	
	We await further detail as to what will constitute "guaranteed minimum retirement income".

Transfers to UK Schemes	Currently all transfers to UK approved schemes are exempt from income tax, regardless of where the individual is resident. **It is proposed to restrict this tax exemption on transfers to the UK to just those individuals resident in the UK at the time of the transfer** (unless the individual has not at any time been resident in Guernsey).
End of Service and Gratuity Schemes	In 2017 the States approved the introduction of regulation for pensions and "end of service/gratuity" schemes but, at the time, no changes were made to the Income Tax Law. **It is now proposed that section 40 of the Income Tax Law is amended to introduce a specific tax exemption for such regulated products where the beneficiaries are non-resident and all income of the trust is non Guernsey source** (apart from Guernsey bank interest).
Mortgage Interest Relief	Currently individuals may claim Mortgage Interest Relief on their principal private residence if the loan is from a Retirement Annuity Trust Scheme ("RATS"). This is because technically the money has been borrowed from an "individual resident in Guernsey". **The budget recommends that the legislation is changed to make it explicit that Mortgage Interest Relief is not available if the loan is from a trust, effective from 1 January 2019.**
High earners tax relief	In the 2018 Budget the States agreed that personal allowances and other allowances/deductions would be withdrawn at a rate of £1 for every £3 that a person's income exceeds the Upper Earnings Limit for social security contributions (£142,896 pa in 2018). **For 2019 the Policy & Resources Committee is recommending that the withdrawal threshold is lowered to £100,000 and the withdrawal ratio is decelerated to a rate of £1 for every £5 that a person's income exceeds the withdrawal threshold.** The impact of this will depend on an individual's income and their starting tax allowances. We have provided an illustrative example opposite.

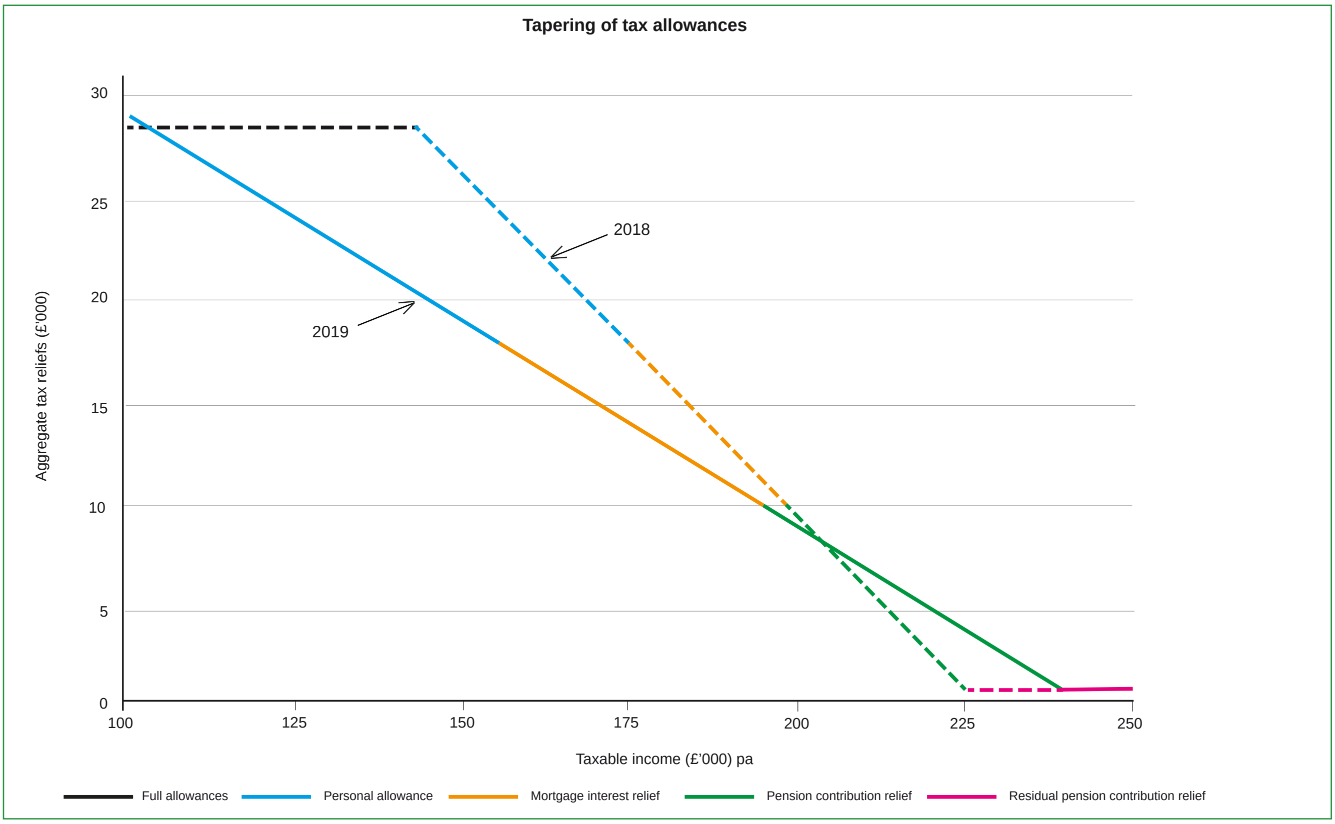
Guernsey high earners tax relief example

The chart considers the impact of the change in the threshold and rate of withdrawal of allowances for an individual who pays £8,000 mortgage interest and £10,000 pension contributions. The chart shows that, in these circumstances, if the individual had an annual income of between £103,000 and £203,000, they would have lower aggregate tax reliefs in 2019 (after allowing for the £500 increase in personal allowance) compared to 2018. However, if they had income above £203,000 they would have higher aggregate tax reliefs in 2019 compared to 2018. The exact cross over point will depend on the individual's starting allowances (which are dependent on various factors, including whether they are paying mortgage interest and pension contributions), but the Budget report expects that:

- a further 1,050 individuals will see their allowances reduced as a result of the lowering of the threshold; and
- 150 individuals will have less allowances withdrawn in 2019.

The allowances are withdrawn in a specific order, with the personal allowance withdrawn first. In this example, mortgage interest relief is next and then pension contributions (other than a small limit of £1,000 which is not withdrawn). These elements of the relief are shown in different colours on the chart.

The 2018 position is shown as a dotted line and the solid line shows the 2019 position.

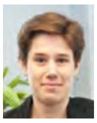


Jersey budget

The Jersey budget includes a couple of minor amendments to the tax rules relating to pensions to ensure that the rules operate as intended.

Aspect	Detail
Taxation of trivial commutation lump sums	In 2018, the restriction on paying a trivial commutation lump sum once an individual had commenced pension benefits was lifted. Since 30% of a trivial commutation lump sum is payable tax-free, this led to the situation that a person could receive a 30% tax-free lump sum from age 50, and then another 30% tax free lump sum if the value of the remaining benefits fell below the £35,000 triviality limit and were subsequently trivially commuted. This was never the intention and it is proposed that, **with immediate effect, changes will be made to the Income Tax Law to prevent individuals using the different commutation provisions to access more than 30% of their pension fund tax-free.**
Commutation post transfer	Currently, if an individual has received any level of lump sum before transferring their pension fund to another arrangement, none of the transferred fund could then be taken into account when determining the maximum future lump sum payable from the receiving scheme. **It is proposed to relax this restriction if the receiving scheme has received full details of any previous commutations from the scheme manager of the transferring Jersey scheme.**

Guernsey Insurance Regulation Changes



"additional information will be required"

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Instruments affected

- The Insurance Business (Public Disclosure of Information) Rules, 2018
- The Licensed Insurer's (Conduct of Business) Rules, 2018
- The Insurance Business (Solvency) (Amendment) Rules, 2018
- Guidance Note on Licensed Insurers' Own Solvency Assessment
- Guidance Note for Licensed Insurers on Reinsurance and Other Forms of Risk Transfer
- Guidance Note for Licensed Insurers on Category 6 – Non-Special Purpose Insurers
- Guidance Note for Licensed Insurers on Change of Majority Shareholder Controller

In April of this year, the Guernsey Financial Services Commission (the "Commission") launched a public consultation on a number of proposed changes to insurance regulation in the Bailiwick, in a document entitled "Insurance Regulation Omnibus Consultation Paper". Following the consultation period, the Commission released a feedback paper in August, as well as final changes to affected rules and guidance notes.

The changes cover many facets of insurance regulation and have varying implementation dates and transitional rules. Many of the changes have been made to align regulation with the Insurance Core Principles promulgated by the International Association of Insurance Supervisors.

We have highlighted those changes which are expected to apply most widely. However directors and compliance managers of licensed insurers will need to become familiar with all of the new rules and guidance notes. Further details of the feedback paper can be found on the Commission's website at: https://www.gfsc.gg/news/article/insurance-regulation-omnibus-consultation-%E2%80%93-feedback-paper

Public Disclosure of Information

The new public disclosure rules apply to insurance companies with a year-end falling after 31 August 2018.

The new rules apply to all licensed (re)insurance companies with the exception of captive insurers, special purpose insurers, all PCCs and non-Bailiwick incorporated entities. Excepted (re)insurers will remain subject to the 2010 Public Disclosure Rules previously in force.

The new public disclosure rules aim to ensure relevant information is more readily available to persons with a valid interest, whilst maintaining a proportional approach. All (re)insurers will be required to make available annual audited financial statements. However where there are commercial policyholders, or the non-disclosure of information could potentially distract from enhancing market discipline, additional information will be required to be disclosed, including key features of the (re)insurer's risk profile and corporate governance framework.

There is provision within the new rules for an (re)insurer to withhold, redact or summarise any information normally subject to public disclosure. In these cases, the insurer must be able to provide the Commission with the reasons for any such non-disclosure.

Conduct of Business

The new conduct of business rules apply from 3 August 2018, although there is a six-month transition period until 3 February 2019. Thereafter, insurers will be expected to achieve full compliance.

Both life and general insurers writing business to retail customers will be affected by these new rules. They relate to the fair treatment of customers and cover the entire relationship with the customer, from the development, distribution and promotion of insurance products to the provision of information and advice to customers, to the servicing, claims and complaints handling processes.

Solvency

This amendment is effective from 3 August 2018 and broadens the scope of the full Own Risk and Solvency Assessment ("ORSA") requirement. However, the first ORSAs will not be required until 2019, or even 2020. Whereas previously reinsurers were exempt from completing a full ORSA and could instead prepare a more limited Own Solvency Capital Assessment ("OSCA"), life reinsurers with a Minimum Capital Requirement ("MCR") of at least £7.5 million and general reinsurers with an MCR of at least £7.0 million will now fall within the scope of the full ORSA requirement.

The Commission has also redefined the scope for insurers required to produce a full ORSA, but captive insurers and PCCs remain exempt. For those (re)insurance companies required to undertake a full ORSA, the frequency of solvency reporting has increased to every six months. The half year Regulatory Solvency Assessment will need to be submitted to the Commission no later than 60 days following the end of the half-year reporting period. The Commission has also revised its Guidance Note on Licensed Insurers' Own Solvency Assessment to provide further details of the change.

Guidance Note

The guidance note was issued on 3 August 2018 and applies to all licensed (re)insurers. It sets out the Commission's expectations with respect to reinsurance and other forms of risk transfer as part of their risk management framework. Notably:

- Ceding insurers must have a reinsurance programme that is appropriate to their business, and that is part of their wider underwriting, risk and capital management strategies
- Insurers should establish effective internal controls over the implementation of any reinsurance programme
- Insurers should consider the impact of reinsurance programmes on liquidity management.

Life expectancy: An international view

"some countries have seen the opposite trend to the UK"

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In the quarter 2 2018 edition of Bandwagon we noted how the UK has been experiencing a slowdown in mortality improvements since 2011. The Office for National Statistics (ONS) subsequently released the results of an international study, which looked at recent changes in life expectancy. The ONS's study suggests that the UK's recent experience is not unique.

Survey results

The ONS analysed data from the Human Mortality Database. The results indicate that over half of the 20 countries considered had seen a reduction in the rate of mortality improvements in the last 6 years relative to the preceding 6 year period. The analysis is not saying that life expectancy is reducing (at least not yet), but that the rate of improvement relative to the previous 6 year period, is lower. Improvements in life expectancy are measured in terms of weeks per year over a person's entire lifetime from birth.

The charts show the change in the average annual increase in life expectancy at birth for males and females over two successive 6 year periods.

For both males and females, the UK has experienced the greatest slowdown amongst the 20 countries considered; annual rises in life expectancy reduced by 13.1 weeks for males and 11.7 weeks for females, relative to the previous 6 years. The USA was not too far behind. However, what is particularly intriguing is that a minority of countries have seen the opposite trend to the UK, with an increase in the rate of improvement in life expectancy.

What's behind this?

A deeper analysis of the data points to the slowdown in the mortality improvements in particular generations as contributing to the patterns being observed. For example, the 65 to 79 age bracket experienced a slowdown in the majority of countries considered.

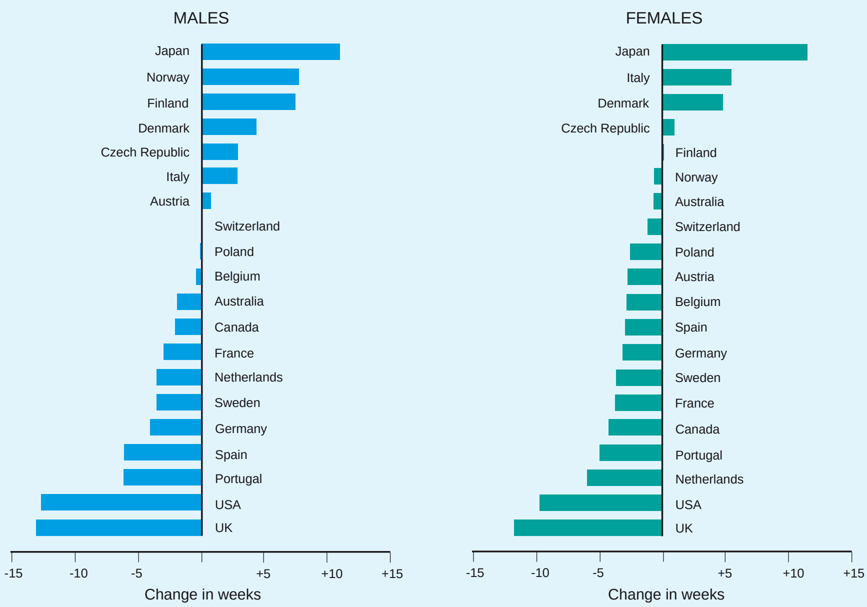
The study does not provide an analysis of the reasons for these particularly noticeable reductions amongst this age group. However, it could be a reflection of a slowing rate of medical advances during the 21st century, compared to that during the 20th century. Additionally, the reduction in smoking rates, which has contributed to improving life expectancies in the past, may no longer be having an effect. This is because there is limited capacity for further reductions in smoking rates.

Are slower improvements the new norm?

As many of the countries experiencing significant slowdowns in life expectancy improvements are highly developed, might this be a natural occurrence as economies and populations mature? The data does not support this; Japan (the country with the highest life expectancy in the world) showed the largest increase in the rate of improvement in life expectancy.

The slowing down of life expectancy improvements in the UK has had significant media coverage. However, realistically it is unlikely to continue increasing indefinitely. Perhaps one of the key points to take away from the ONS report is that looking beyond our borders at the changes that are occurring elsewhere is vitally important in an increasingly connected world.

Change in life expectancy at birth between successive 6 year periods



[1] https://www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/lifeexpectancies/articles/changingtrendsinmortalityaninternationalcomparison/2000to2016

2018 Mind Sports

17th Mind Sports Challenge

We are delighted to be supporting the Guernsey Mindsports workshops and Challenge again this year, which will take place over the October half term week, beginning on Monday 29 October.

Aimed at students in school years 3 to 10, the workshops provide a great opportunity to learn how to play a range of strategy games. No previous knowledge is necessary, although experienced players who would like an opportunity to work on their strategy are equally welcome.

The format will be very similar to previous years, with four days of workshop sessions before the Championship event at the end of the week.

There will also be an opportunity for families to get involved with an open session on Saturday 3 November, followed by the prize giving.

Key Information

New venue: Elizabeth College

Additional workshop: Monday morning

For further details, including the form to book a place, please see the weblink below:

https://www.bwcigroup.com/News/ViewArticle/1040

Or visit the Guernsey Mind Sports Facebook page

Charity News

With around 120 of us now, getting together to raise money for a good cause is a great way for BWCI staff and partners to catch up with others in different departments. Therefore, when Credit Suisse our near neighbour along Guernsey's South Esplanade, opened up their Hel(l)vetia Challenge to others , we jumped at the chance to take part.

Now in its second year, the Challenge is a triathlon-inspired event which takes advantage of Guernsey's spectacular coast line immediately outside Credit Suisse's offices.

There are three separate elements; swimming from Castle Cornet, cycling up and down the formidably steep and winding Val des Terres and then running along the coast and back to Castle Cornet.

It proved particularly popular, with 15 of our staff and partners taking part, either as part of a team with each member taking on one of the activities or the challenge of completing the entire circuit of three disciplines on an individual basis. With perfect weather conditions, it was a fantastic way to raise funds for our chosen charity this year, the Guernsey Bereavement Service.

The funds raised by BWCI were then matched by the BWCI Foundation. The whole event was a huge success, with 35 different teams from across Guernsey's business community aiming to raise £50,000 for charitable causes.

There was more swimming involved in the latest BWCI team fund raising activity, when six staff and partners from several departments took part in the Guernsey Swimarathon.

The Hel(l)vetia Challenge

BWCI's Swimarathon team

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