Bandwagon

The BWCI Group Newsletter

BWCI

Quarter 4 - 2017

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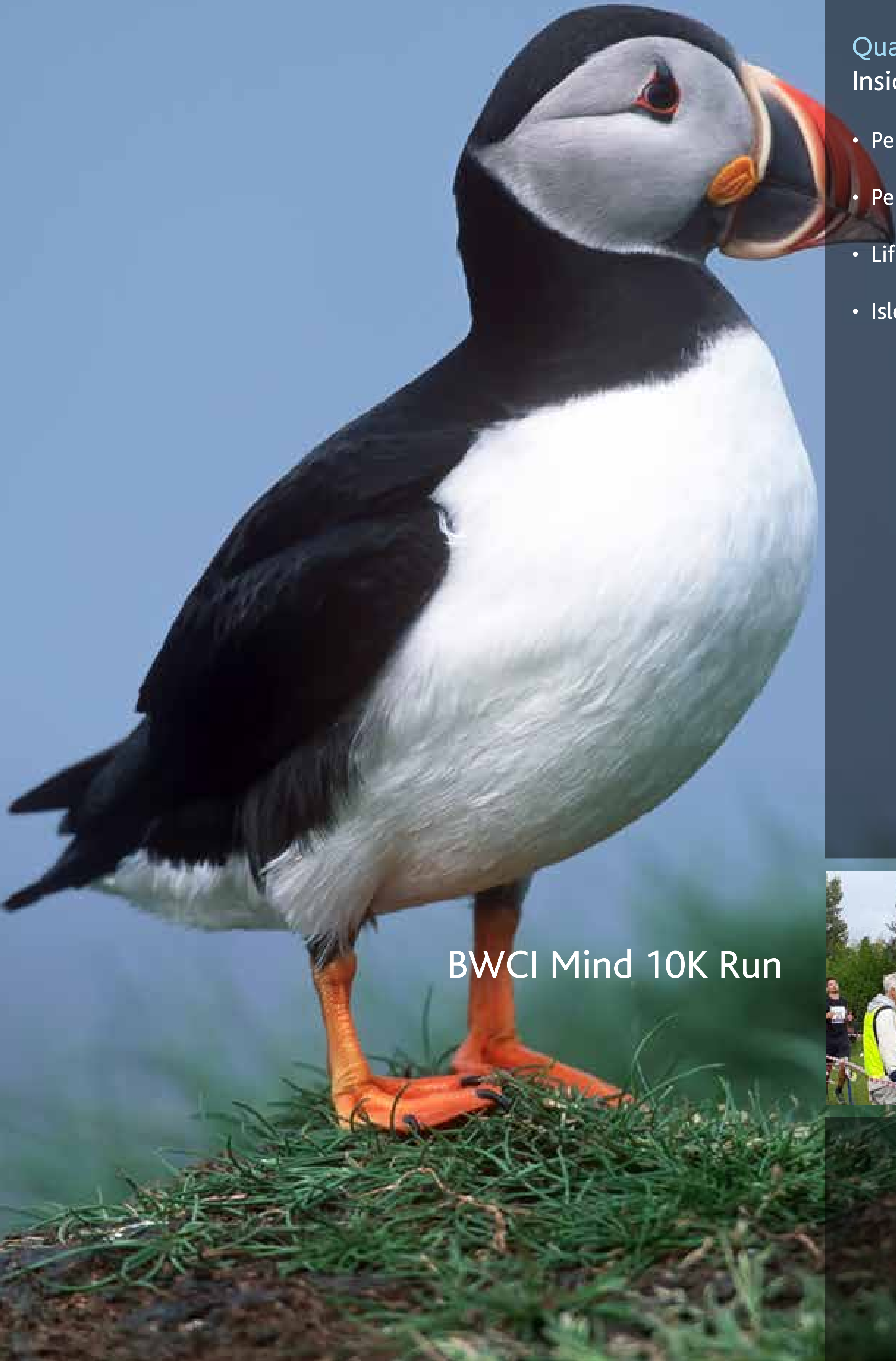


BWCI Mind 10K Run

Countdown to Guernsey Pension Regulation

The clock is ticking as the deadline approaches for Guernsey licensed fiduciaries who undertake the "formation, management or administration of pension and gratuity schemes" to be fully compliant with the new pensions regulatory framework. The 30 September 2018 deadline is already less than a year away; there is much to be done.

We are working with a large number of schemes and providers to analyse their current arrangements. This analysis is needed to identify where changes will need to be made over the next few months.

Some general trends are beginning to emerge from the analysis we have done so far. Schemes which already have good standards of governance will not need to take much action to be compliant. However, for other schemes, the review has provided a good opportunity to put in place more formal processes and procedures.

One new requirement that will affect all licensees is the annual scheme return. All information will need to be submitted through the Guernsey Financial Services Commission's Online Submissions Portal. Further details can be found at:

https://www.gfsc.gg/industry-sectors/pensions

If you would like any assistance with identifying whether your scheme may be affected, or what action may be required, please contact your usual BWCI advisor or email Michelle Galpin at mgalpin@bwcigroup.com.

Pat Merriman 1926 - 2017

Pat Merriman

In this issue we mark the passing of Pat Merriman, who died at the end of August. Pat was a remarkable actuary and businesswoman, who inspired the formation of what has developed to become the BWCI Group.

Pat excelled at mathematics at school and was awarded a place at Newnham College Cambridge in 1944. She never wanted to take up a typical "ladies' profession" such as teaching, but had heard of the actuarial profession while at school. She applied to Bacon & Woodrow in London when she graduated from Cambridge in 1947. It was far-sighted of Bacon & Woodrow to appoint Pat, as their first graduate trainee, especially as the actuarial profession was almost exclusively male at that time. Pat took to the actuarial profession and qualified in 1951, becoming only the tenth lady to qualify as a Fellow of the Institute of Actuaries. She progressed rapidly within Bacon & Woodrow and in 1959 became the first ever female partner in a firm of consulting actuaries in the UK.

One of Pat's strengths was her ability to generate new ideas to develop the business – and undoubtedly one of her best ideas was to establish a Guernsey Office in 1979.

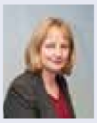
As the Guernsey Office developed and evolved into BWCI, Pat spent more and more of her time here. She played a key role in the business life of the Island, being part of the Guernsey International Business Association committee for many years. She also inspired the creation of the Channel Islands Actuarial Society and the Guernsey Association of Pension Funds.

"a source of encouragement and inspiration"

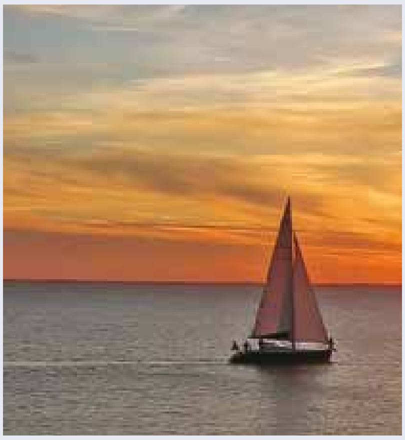
In 1991 Pat reached retirement age but continued with the firm as a consultant partner, retaining some of her long-standing clients. This interest in the firm continued throughout her life and, even until this year, Pat could still be found in the offices occasionally to share her latest ideas.

As Stephen Ainsworth, BWCI's Senior Partner, commented, *"Pat has been a source of encouragement and inspiration to whole generations of actuaries and will be missed by us all."*

Pension Budget Changes



"high earners should consider if they are able to bring forward any planned contributions for future years"
Michelle Galpin



The first two weeks of October saw the publication of the 2018 budgets for both Jersey and Guernsey. The Guernsey budget was agreed at the beginning of November and the Jersey budget is due to be considered at the end of November. The budget changes will have some implications for pension schemes in both islands.

All of the changes would take effect from 1 January 2018.

Guernsey Changes

The two pension-related changes in Guernsey are:

1 Tax relief on Pension Contributions

An individual can make unlimited contributions to an approved pension arrangement. However, tax relief on these contributions is limited to the lower of 100% of taxable income and £50,000. This monetary limit will be reduced to £35,000.

The budget report explains that 9,800 individuals currently make pension contributions. 87% of those claiming tax relief pay contributions of no more than £5,000 pa. Only 130 people contributed over £35,000.

2 Tax relief for high earners

High earners are defined as those with an income in excess of the Upper Earnings Limit ("UEL"). This is expected to be increased to £142,896 in 2018. From January 2017 personal allowances for high earners were withdrawn at a rate of £1 for every £3 that a person's income exceeds the UEL.

From 1 January 2018 most of the tax relief on pension contributions will also be phased out for high earners. The impact on an individual will depend on their own personal circumstances, but in the worst case scenario, the tax allowance would be reduced to £1,000, equivalent to tax-relief on contributions of just £200 pa.

Action before Guernsey Changes

While the reduction from £50,000 to £35,000 is not expected to affect many people in practice, for those who are impacted, there is a small window, up until the end of 2017, to maximise their tax relief on their 2017 contributions.

It may be possible to pay in more than £50,000 in 2017 in certain circumstances and obtain full tax relief, by using up any carried forward tax-relief from the previous 6 years.

Those affected by the more significant reduction in tax-relief on contributions for high earners should consider if they are able to bring forward any planned contributions from future years, to ensure that they maximise the tax relief available in 2017.

Jersey Proposals

Four pensions - related changes are proposed. These would increase the flexibility around the commutation of small benefits and the transfer of pension benefits from one scheme to another.

1 Commutation of very small pension funds

Previously this option was only available to occupational pension schemes. It is proposed that this flexibility be extended to all approved pension arrangements. This would enable a pension holder to commute their pension benefits at any age, provided that the value was not more than £19,000.

There would also be an overall limit of £50,000 on all small benefits commuted under this option. This is designed to prevent people from accessing all of their pension savings as lump sums by breaking them up into smaller pots. Any lump sums taken would be treated as taxable income.

2 Trivial commutation

The standard trivial commutation limit is increased from £30,000 to £35,000. The Jersey Income Tax Office has confirmed that the £50,000 limit does not include benefits commuted under this option.

3 Bulk Transfers

It is proposed that occupational pension schemes will be able to make bulk transfers, in respect of some or all of their members, to another Jersey approved occupational scheme, provided that the written approval of the Comptroller of Income Tax is obtained in advance. The Comptroller would need to be provided with details, including which members were covered by the bulk transfer, which members (if any) were not being transferred and the benefits and assets involved.

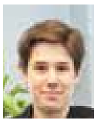
4 Overseas Transfers – Anti Avoidance Measures

There is a proposal to change the requirements around overseas transfers to prevent the deliberate avoidance of the payment of Jersey tax. This could arise where a Jersey resident moves overseas temporarily.

The change is seeking to avoid the situation where a person transfers their funds from a Jersey approved pension arrangement to another jurisdiction and then subsequently cashes in the whole fund. If the person then returns to Jersey, either in the year that the funds are cashed in or the subsequent three years, they would be deemed to have received a lump sum payment from the overseas scheme on their return to Jersey; Jersey tax would be payable on this lump sum.

This change would result in the removal of the three year time restriction before a person, who was previously resident in Jersey, could transfer out their pension benefits to their new jurisdiction.

Personal Injury Compensation



"The new approach is intended to be fair to all parties"
Clair Le Poidevin

The consequences of a serious personal injury can be life-changing, often leaving those affected unable to work. They may need help with daily activities, or even nursing care for the rest of their lives. Whilst no amount of financial compensation can make up for the the impact on their quality of life, insurance can at least help alleviate the financial pressures.

Law of Damages

Under civil law, when a person is injured the court typically awards compensation to cover financial losses – past, present or future. The amount of compensation will reflect whether the losses are certain or contingent. Future contingent losses primarily relate to the loss of future earnings, the cost of care and medical expenses.

Types of Compensation

In the UK the award can take the form of a lump sum, periodical payments or a combination of both. The aim is to place the injured party in the same financial position they would have been in if they had not been injured. It should neither under compensate nor over compensate – the "100% rule".

The Ogden Tables

The Ogden Tables are designed to assist with the valuation of future monetary losses in UK personal injury and fatal accident claims where a lump sum is being paid. The tables are produced by the Government Actuary's Department using population life expectancy data. The first edition was published in 1984, and the tables have been updated regularly since then reflecting improvements in life expectancy and other developments.

The set of tables provide multipliers, and detailed guidance on how they should be applied, to place a capital value on a loss. The choice of discount rate to use is a key decision in the application of the Ogden Tables. This is because the discount rate effectively allows for the expected future investment return that will be earned when the lump sum is invested.

The lower the discount rate the higher the compensation payment. This is because less investment return is expected to be earned on the capital payment in the future, so the initial lump sum payment needs to be higher.

Discount Rate Change

In February this year the Lord Chancellor announced a significant change to the discount rate to be used by UK Courts cutting it by 3.25% from 2.5% to -0.75%pa. The scale of the change reflected the fact that this was the first time a change had been made in 16 years.

The impact of a significantly lower discount rate, which came into effect from 20 March 2017, resulted in a substantial increase in the size of insurance payouts, particularly for younger claimants.

The far-reaching consequences of the discount rate change included an increase in the cost of compensation payments in NHS negligence cases. In response, insurers sought both to recover the additional costs incurred, as well as setting aside reserves to fund future claims, by passing on the costs to consumers through increases in premiums.

Industry Challenge

The discount rate change was challenged by the insurance industry. As a result the UK Government committed to review the way the discount rate is calculated. Draft legislation was published in September, setting out how discount rates should be set in the future, paving the way for a more modest reduction to the original 2.5%pa rate. The 100% compensation principle has not changed under the new draft law.

Choice of discount rate

The discount rate previously had to be set in accordance with the Damages Act 1996, taking account of the legal precedents set in Wells v Wells. Since 2001 it has been assumed that the claimant would invest only in index-linked gilts, a "very low risk" strategy.

Following a fall in bond yields this was no longer thought to be realistic. Under the new draft law a slightly higher, but still "low risk", diversified portfolio of investments is used to set the discount rate. Under the new approach, if the discount rate were set today it is estimated that it would be in the range of 0% to 1%pa.

Future discount rate reviews

The new discount rate is to be reviewed promptly after the legislation comes into force. Thereafter, it is to be reviewed at least every three years (this period being re-set when the rate is updated) to avoid long periods over which it may become out of date.

It will continue to be set by the Lord Chancellor, but under the new approach, it would be after consulting with an expert panel. This panel is to be chaired by the Government Actuary and includes four other members with relevant knowledge.

Conclusions

Insurers will need to consider how this second change in the discount rate affects the reserves that they are holding for current and future claims that are yet to be settled.

The new approach is intended to be fair to all parties.

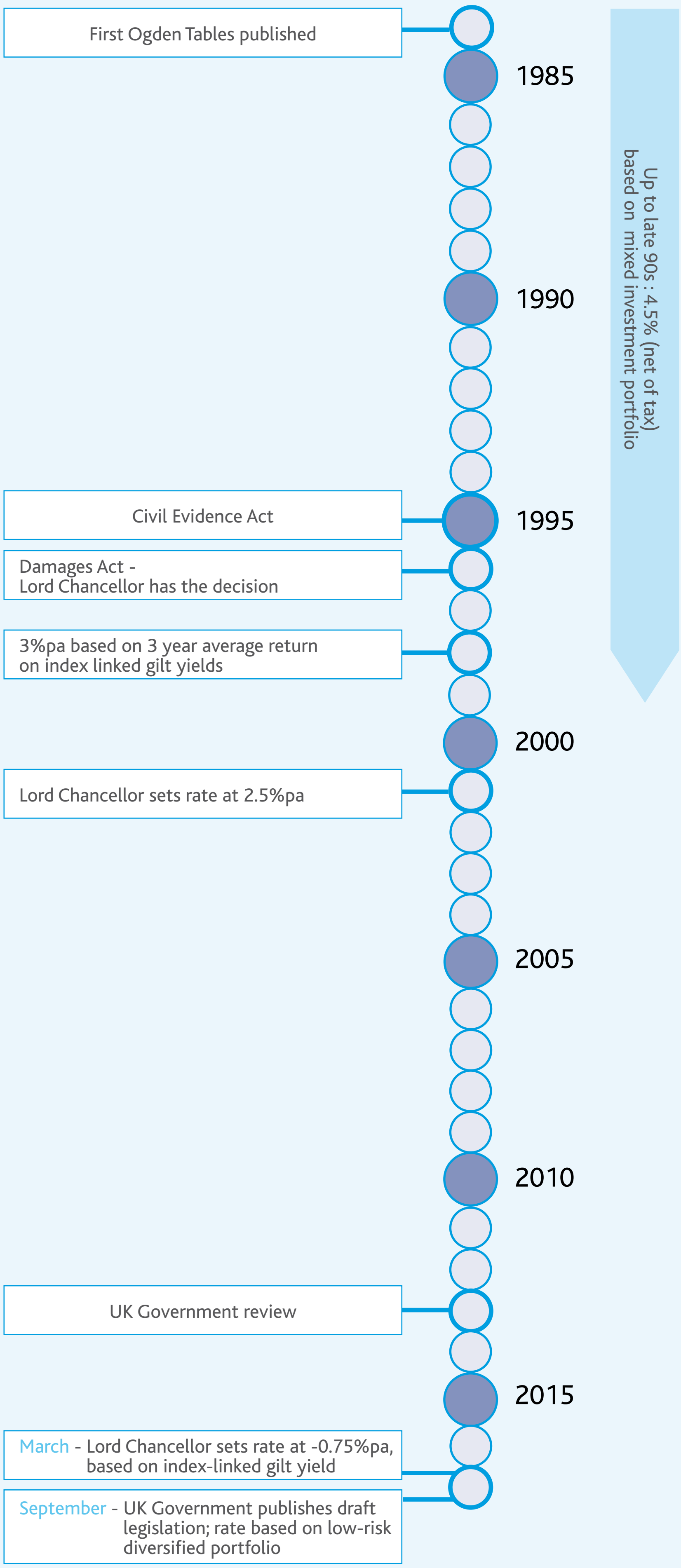
Claimants – will receive fair compensation for their financial losses.

Insurers – will not be penalised due to the low (or negative) bond yields.

Consumers – premium increases will be smaller

While the proposed approach to determining the discount rate is expected to cause less financial strain than the fundamental change announced in February, it is still expected to increase the value of damages claims, substantially in some cases.

Discount Rate Timeline



Life's a Game of Give and Take: Focus on Longevity Swaps

"Guernsey has established itself as the predominant location for longevity swaps placed through captives"
Graydon Bennett

For further information,
please contact Graydon Bennett
at gbennett@bwcigroup.com.

Increases in life expectancy are a source of risk and uncertainty for trustees of defined benefit pension schemes. Over the last decade a number of structures for managing this longevity risk have emerged, including the pension buy-in, the pension buy-out, and the most recent innovation, the longevity swap.

Structure of a Longevity Swap

The objective of a longevity swap is to allow the pension scheme to exchange a stream of uncertain future pension payments for the security of a known series of future payments.

The pension scheme enters into an agreement to transfer its longevity risk using a swap with fixed and floating legs. It does this by exchanging a commitment to make future fixed payments (based on estimated future pension payments) in return for another party's commitment to meet the uncertain actual future payments (the floating leg). The ultimate counterparty in the transaction is usually a reinsurer. However, as reinsurers are not permitted to transact directly with pension schemes, often a captive insurer of the pension scheme's sponsor will act as an intermediary.

The pension scheme usually pays an additional premium as a contribution towards the costs and risks incurred by the counterparty committed to meeting the actual future payments. The transaction only covers the difference between the actual and projected pension payments. Therefore, the investment risk remains primarily with the pension scheme.

Collateral Requirements

The operation of the swap depends on monitoring the actual cash flows and comparing these with the agreed fixed payments. Both parties will be concerned that any changes in actual or projected experience could have a material impact on future collateral payments. To address this concern the pension scheme and the insurance company are each required to post collateral, depending on past experience and the projected net cash flow. The collateral is held by a custodian.

Calculation Agent

A calculation agent determines the value of collateral to be posted at the inception of the swap. The agent also revalues it periodically throughout the life of the transaction. This work is usually undertaken by an actuary.

Guernsey as a Jurisdiction

Guernsey has established itself as the predominant location for longevity swaps placed through captives. It is important that the captive demonstrates its presence in Guernsey, to avoid potential tax risks that could arise when dealing with a UK pension scheme.

In 2014 the British Telecom pension scheme executed a £16bn longevity swap with a US-based life insurer through a Guernsey captive. This was followed by a £1.5bn transaction for the Merchant Navy Officers Pension Fund.

To date, all the major longevity swaps transacted in Guernsey have been completed using an Incorporated Cell Company or ICC – a structure which is not possible in the UK.

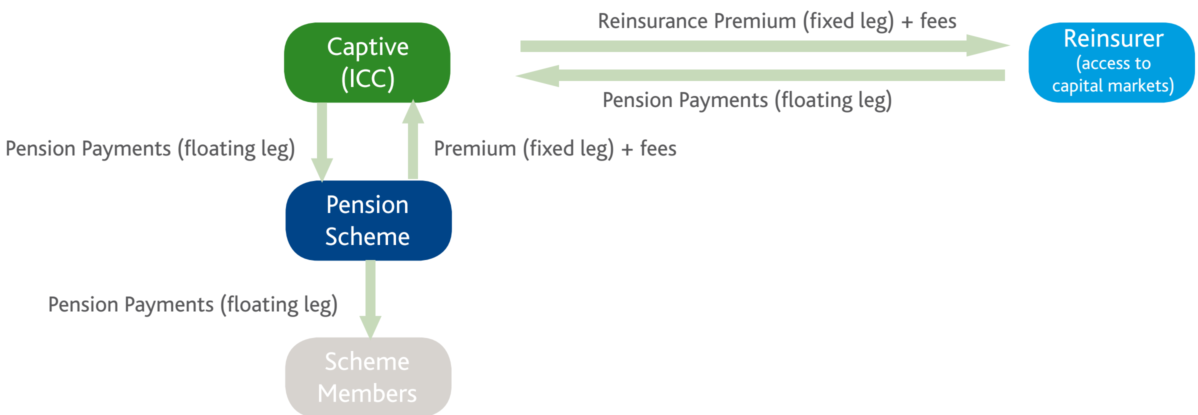
Recent Transactions

Details of a further two large longevity risk transfers, which were executed in Guernsey, were announced in September 2017. First, the pension scheme for Marsh & McLennan companies completed a longevity swap using a Guernsey-domiciled ICC to hedge the longevity exposure in £3.4bn of its pension liabilities. A week later, it was announced that one of British Airways' pension schemes had agreed a deal to hedge the longevity risk inherent in £1.6bn of its defined benefit pension liabilities.

Conclusion

Over the last few years longevity swaps have become the 'hot topic' among pension scheme trustees concerned about their scheme's exposure to longevity risk. Guernsey has presented a compelling case and solid track record to be the preferred domicile for a captive or ICC solution to the longevity risk question.

Longevity Swap Cashflows



Isle of Man Pension Freedoms?

"available to both residents and non-residents"
Amber Buckingham

Over the summer the Isle of Man Treasury launched a consultation on the possible introduction of a new pension scheme that would potentially provide greater pensions freedoms.

Background

The UK introduced its Pension Freedoms over two years ago now in April 2015, allowing people unrestricted access to their defined contribution pension savings from as early as age 55, subject to a tax charge. This was a fundamental change in approach to retirement savings. While many people welcomed the opportunity to get their hands on their money as early as possible, some were more cautious, as it was unclear what people would do with their pension savings. Would they end up unable to support themselves much later into their retirement and then potentially become a severe financial burden on the State and the next generation of tax payers?

Tynwald Motion

The issue was first debated in the Isle of Man in July 2015. The Government at that time did not want to follow the UK. However the Government was defeated with Tynwald approving the motion:

"That Tynwald supports the concept of pension freedom, and is of the opinion that Treasury should bring forward by October 2015 proposals to allow Manx residents pension freedoms equal to or better than those currently available in the UK."

2016 Budget changes

This three month timescale for considering the implications and delivery of the proposals always looked optimistic and it was not achieved in practice.

However, the Isle of Man's 2016 budget did introduce some measures which provided some additional flexibility allowing greater lump sums to be taken from pensions savings in some circumstances:

- The trivial commutation limit was increased from £30,000 to £50,000
- The age at which a trivial commutation/fund remnant lump sum can be paid was reduced from 60 to 55

Proposed New Pension Scheme

Since that time the Treasury, together with the Department of Economic Development, have continued to work with the pensions industry to identify how best to introduce further pension freedoms in the Isle of Man, whilst protecting the pensions industry and general revenue. This culminated in the publication of a proposal document "Proposed New Pension Scheme to Provide Greater Pension Freedoms" in July 2017.

The proposed new product would provide certain pension scheme members, who have pension pots which exceed the current trivial commutation and fund remnant thresholds (currently £50,000 and £71,428 respectively) with greater flexibility to access their pension pots.

It would be available to both residents and non-residents. However the new scheme would be limited to no more than one per person. It would be possible to transfer funds from an existing approved scheme (but not defined benefit schemes) into the new product.

The consultation process closed on 15 September 2017. However, at the time of going to press, no response has yet been published.

Key Features of New Type of Pension Scheme

- a minimum retirement age of 55
- no maximum retirement age
- tax relief on contributions:
  - up to an annual contribution limit of £5,000; and
  - allowed at the rate of 10%
- pension growth builds up tax-free
- full access on reaching the scheme retirement age, including the ability to take the whole of the pension pot in one withdrawal or to take smaller withdrawals as required
- 40% tax-free lump sum
- remainder of funds are subject to income tax at a rate of 10%
- no tax on death

Our Swimarathon team

Six members of the BWCI team donned their swimwear to take part in the Skipton Swimarathon. Organised jointly by the Lions Club of Guernsey and the Guernsey Round Table, this year's charity swim was raising money for the project to refurbish the Guilles –Alles Children's Library.

Between them, our team swam almost 3.5km by completing 138 lengths of Beau Sejour's 25 metre pool in their hour's slot.

The funds they raised from BWCI staff were doubled up by the BWCI Foundation.

Team Members: Left to right Richard Wright, Hannah Gibson, Kyia Murray, Mark Colton, Carl Stanford and Luke Richards.

BWCI 10K Mind Run

A record number of 402 people registered for this year's BWCI Mind 10K run, with more than 340 going on to complete the scenic circular course which took in a challenging mix of hills and country lanes.

The runners had to battle against a strong wind as they completed the second half of the loop along the west coast. However, despite the weather conditions, many still managed to finish in impressive times. After a close race at the front, Island Games athlete Carl Holden managed to break free of the chasing pack and was the first one home in just under 35 minutes.

For experienced athletes this is Guernsey's last road race of the season. However, the real focus of the event has always been to encourage mass participation and wider inclusion to promote the benefits of exercise on positive mental health.

We were delighted that the run was so well supported again this year, which has helped to raise over £7,000 for Mind from the entry fees and donations.

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